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October 16, 2002

Via Electronic Filing
Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW, Room TWB-204
Washington, DC 20554

Re:
In the Matter of Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers and Implementation of the Local Competition Provisions in the Local Telecommunications Act of 1996, CC Docket No. 01-338; 96-98; 98-147

Dear Ms. Dortch:

Yesterday, AT&T provided the following documents to Chairman Michael K. Powell, Commissioners Kathleen Q. Abernathy, Michael J. Copps, Kevin J. Martin and Jordan Goldstein, Legal Adviser for Commissioner Copps, Dan Gonzalez, Legal Adviser for Commissioner Martin, Matthew Brill, Legal Adviser for Commissioner Abernathy, and Christopher Libertelli, Legal Adviser for Chairman Powell. AT&T is filing this document in the aforementioned docket because it references the use restriction and commingling issues currently at issue in the Triennial Review proceeding.

In accordance with the Commission's rules, one copy of this Notice for each referenced proceeding.

Sincerely,

Robert W. Quinn/PKA

cc: without attachments
Chairman Powell
Commissioner Abernathy
Commissioner Copps
Commissioner Martin
Jordan Goldstein
Matthew Brill
Daniel Gonzales
Christopher Libertelli

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington D.C. 20554

In the Matter of	)	
AT&T Corp.	)	
Petition for Rulemaking To Reform Regulation Of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services	)	WC Docket No. 02-____

PETITION FOR RULEMAKING

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October 15, 2002

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PETITION FOR RULEMAKING

Pursuant to Section 1.401 of the Commission's Rules, 47 C.F.R. § 1.401, AT&T Corp. ("AT&T") hereby requests that the Commission promptly initiate a rulemaking to reform regulation of price cap incumbent local exchange carrier ("ILEC") rates for interstate special access services. As detailed below, there is now indisputable proof that: (i) large ILECs, and particularly the Bell Operating Companies ("Bells"), retain pervasive market power in the provision of these services, (ii) the large ILECs are abusing that market power with patently unjust and unreasonable rates that impose a multi-billion dollar annual overcharge or tax on American businesses and consumers and also severely harm both local and long distance competition, (iii) the Commission's existing rules are incapable of addressing this worsening crisis, and, indeed, only exacerbate the problem, and (iv) the Commission therefore has a clear legal obligation promptly to reform its regulation to protect the public interest and to put an end to these monopoly abuses.

INTRODUCTION AND SUMMARY

The Commission has been duped. For several years now, the Bells have been peddling the story that they face substantial competition in the provision of high capacity loops and transport and that the only appropriate Commission response is reduced regulation and greater reliance upon market forces. In order to "meet competition" from many alternative suppliers of loops and transport, the Bells have argued, they have an urgent need to escape rate regulation of their own special access services.

The Bells' approach to selling their special access tale has been quite clever. Early on, they recognized the futility of attempting to supply evidence of actual competition that creates market forces adequate to constrain their power over price. The marketplace reality is that, despite limited, targeted entry, price-constraining levels of competition in the provision of special access services simply did not (and do not) exist in any local market, as even regulators in the local markets with the *most* competitive activity have recently held. Thus, although the Bells knew full well that they were (and are) the *only* suppliers of high capacity local links to the vast majority of buildings, they proffered the novel, and, at the time, largely unverifiable, theory that the existence of some collocation in some of a Bell's central offices in an area signals sufficient competition to justify rate flexibility and, ultimately, rate deregulation. Without access to the contrary facts in the Bells' sole possession, the Commission made a predictive judgment that the Bells' theory was sound, and, noting the great deference owed to such predictive judgments, the court of appeals affirmed.

The Bells responded with a torrent of "pricing flexibility" requests, and, to no one's great surprise, they had little trouble meeting the "competitive triggers" that had been adopted. Today, more than half of the Bells' special access revenues come from areas in which they are no longer

subject to price cap regulation. On current trends, special access rate deregulation will be all but complete by the end of next year.

That would have the makings of a great regulatory success story, but for the unfortunate fact that the Bells' own subsequent actions and submissions to the Commission have exposed their story – and the entire foundation of reduced regulation of their special access rates – as a fraud. The Bells' claims that their rates are constrained by market forces were false when made, are false today, and will remain false for the foreseeable future. The Bells have not used rate deregulation to meet competition, but to gouge both their captive special access customers and the general public. The Bells' already exorbitant special access rates and revenues have soared, and the ever-increasing annual returns that the Bells enjoy on those services are now as much as *50 percent* or more. The Bells' special access windfalls already represent at least a *$5 billion* annual direct tax on American businesses and consumers, and the problem is only worsening. The Bells' unjust – and, as compared to the Bells' own costs of accessing the underlying facilities, patently discriminatory – special access rates are also among the greatest threats to both local and long distance competition. In short, special access rates that have long been a problem have now become an industry crisis that portends irreversible harm to competition and consumers. Immediate Commission action is imperative.

The relevant facts are straightforward and indisputable. As the Bells' own ARMIS reports confirm, their special access returns – and hence the special access rates that have produced those returns – are, without exception, both grossly excessive and rapidly rising. Indeed, the colossal returns reflected in the Bells' *embedded cost* ARMIS data greatly understate the Bells' windfalls. Comparing the Bells' special access revenues to their true economic costs of providing those dominant carrier services reveals that their annual returns are simply obscene

– rates are more than *double* costs. In *every* area in which they have received pricing flexibility, the Bells have avoided the substantial "X-Factor" productivity reductions that would otherwise have been required in the absence of pricing flexibility, and either maintained rates at previous levels or raised rates still further. And, as further confirmation of their enduring market power, the Bells have managed to *increase* their special access sales even as they continue to inflate the rates for those services and to provide their unaffiliated special access customers with remarkably poor (and often deteriorating) performance in delivering those services. Indeed, the Bells' special access revenues have more than tripled since 1996. By any standard, these facts alone establish that the Bells retain considerable power over price, that neither market forces nor the existing regulatory scheme constrains that power, and that existing special access rates are unjust and unreasonable.

The resulting harm to consumers and competition is immense. The dwindling ranks of competing local carriers must, of course, pass on to consumers the Bells' special access rate increases. By charging other carriers these inflated rates, the Bells also avoid retail price competition. This is not lost on business and consumer groups, which are increasingly voicing their opposition to the Bells' special access abuses, most recently in Commission proceedings directed at the other primary outlet of the Bells' special access market power, discriminatory provisioning and poor performance. The Bells' special access rates are, if anything, an even bigger problem. In generating billions of dollars of windfalls each year, the Bells' special access "tax" places a substantial drag on the nation's economy.

But the harm from failing to curb the Bells' special access market power runs much deeper. The Bells' high capacity loops and transport, which are characterized by enormous economies of scale (and sunk costs), remain essential inputs for competitive local exchange

carriers ("CLECs"). Although Congress addressed that reality by requiring the Bells to lease those facilities at forward-looking economic costs, the Bells evade that obligation through the "use" and "commingling" restrictions that the Commission has allowed them to impose on competitors, and thus CLECs have no choice but to pay the Bells' exorbitant special access rates. That gives the Bells, which access those same facilities at their much lower economic costs, an enormous cost advantage in competing to serve both business and residential customers. Worse yet, pricing flexibility (both "Phase I" contract tariffs and "Phase II" rate deregulation) allows the Bells to use anticompetitive price discrimination and profitably to target with predatory rates the small minority of buildings where CLECs might otherwise have a fighting chance. Real customer choice cannot be sustained under these circumstances.

The Bells' unlawful special access rates are equally destructive of long distance competition. Local access is, of course, an essential input for long distance services, and, as the Commission has expressly recognized, absent regulation, the Bells have both the incentive and ability to use inflated access charges to "price squeeze" their long distance competitors. In the past, the Commission has pointed to price cap regulation and network element substitutes for access as checks on Bell price squeezes, but those are obviously no checks at all in the face of rate deregulation and use and commingling restrictions. If the Bells' long distance rivals must continue to pay more than twice the Bells' own forward-looking economic costs of local access, remonopolization is inevitable.

There is only one responsible and lawful Commission solution to this special access crisis. The Commission has ample authority to, and must, initiate a rulemaking and, on an expedited basis, reform and tighten its special access rate regulations to the full extent necessary to protect consumers and competition and to curb the Bells' existing ability to impose unjust,

unreasonable and discriminatory charges for their special access services. At a minimum, the Commission should revoke pricing flexibility and reinitialize price caps to levels designed to produce normal, rather than monopoly, returns. Moreover, existing special access rates are so far out of line with lawful, compensatory levels that the Commission should, as an interim measure, (1) reduce all special access rates subject to Phase II pricing flexibility to levels that would produce an 11.25% rate of return, and (2) impose a moratorium on consideration of further pricing flexibility applications pending completion of the rulemaking. In addition, the Commission should specify that access purchasers may take advantage of this interim relief without triggering any termination liabilities or other penalties in the Bells' optional pricing plans.

This course of action can no longer be considered discretionary. The Communications Act requires that all charges in connection with common carrier services be just and reasonable, 47 U.S.C. § 201, and it is well established that the Commission has a duty to enforce that requirement. There are no circumstances under which permitting the Bells to earn such "creamy returns" at the public's expense could be squared with these requirements.[1] But, as the courts have stressed, where, as here, the Commission has based its existing regulatory regime on a predictive judgment, it is absolutely imperative that "the Commission . . . vigilantly monitor the consequences of its rate regulation rules."[2] "If, in light of the actual market developments, the Commission determines that competition is not having the anticipated effect on access charges," it must "revisit the issue."[3] The existing relaxed (and, to a large extent, now nonexistent) rate

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[1] *Farmers Union Cent. Exchange, Inc.* v. *FERC*, 734 F.2d 1486, 1502-03 (D.C. Cir. 1984) ("*Farmers Union II*").

[2] *American Civil Liberties Union* v. *FCC,* 823 F.2d 1554, 1565 (D.C. Cir. 1987).

[3] *Texas Office of Public Utility Counsel* v. *FCC*, 265 F.3d 313, 325 (5th Cir. 2001); *see also SWBT* v. *FCC*, 153 F.3d 523, 547 (8th Cir. 1998) (same); *see also CELLNET* v. *FCC,* 149 F.3d

regulation of interstate special access reflects predictive judgments that market forces would constrain the Bells' special access pricing. It is now clear that those predictions were wrong and that rate regulation is, and, for the foreseeable future, will remain, vitally necessary to combat the Bells' market power and to ensure that special access charges are just, reasonable and nondiscriminatory.

It is no answer to point out that the Bells' captive customers could file Section 208 complaints to address the Bells' abuses in each of the hundreds of MSAs in which they provide special access services. As the D.C. Circuit has warned, the existence of such a "safety valve" is no defense to a claim that the underlying regulatory regime is unlawful.[4] There is accordingly no scenario in which the Commission lawfully can avoid addressing the special access crisis, and AT&T strongly urges the Commission promptly to initiate the rulemaking sought by this petition.

I. THE BELLS' SPECIAL ACCESS RATES ARE GROSSLY EXCESSIVE AND UNLAWFUL AND ARE BECOMING MORE SO.

It can no longer be disputed that the Bells' special access rates are unjust and unreasonable and that these unlawful rates are not random or temporary occurrences. Rather, fundamental marketplace and regulatory conditions are driving a consistent, industry-wide trend resulting in higher and higher rates of return every year for each Bell holding company. It is equally clear that the Commission's existing scheme of rate regulation is not responding to this

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429, 442 (6th Cir. 1998) ("If the FCC's predictions about the level of competition do not materialize, then it will of course need to reconsider its [regulations] in accordance with its continuing obligation to practice reasoned decisionmaking"); *Bechtel* v. *FCC*, 957 F.2d 873, 881 (D.C. Cir. 1992) (it is "settled law that an agency may be forced to reexamine its approach if a significant factual predicate of a prior decision . . . has been removed.").

[4] *See, e.g.*, *Time Warner Entertainment Co.* v. *FCC*, 56 F.3d 151, 176 (D.C. Cir. 1995).

trend, but instead is allowing it to spiral more and more out of control every year, with increasingly negative consequences for consumers and competition.

The Bells' own ARMIS reports to the Commission establish that the Bells' rates of return on special access are triple, quadruple, *even quintuple*, the 11.25% rate of return that the Commission found just and reasonable for dominant ILEC services in 1990 (which is itself far too high given the much lower inflation and decreased borrowing rates that prevail today). For 2001, the Bells' special access rates of return were as follows:[5]

BellSouth	49.26%
Qwest	46.58%
SBC	54.60%
Verizon	21.72%
Verizon (excluding NYNEX)	37.08%

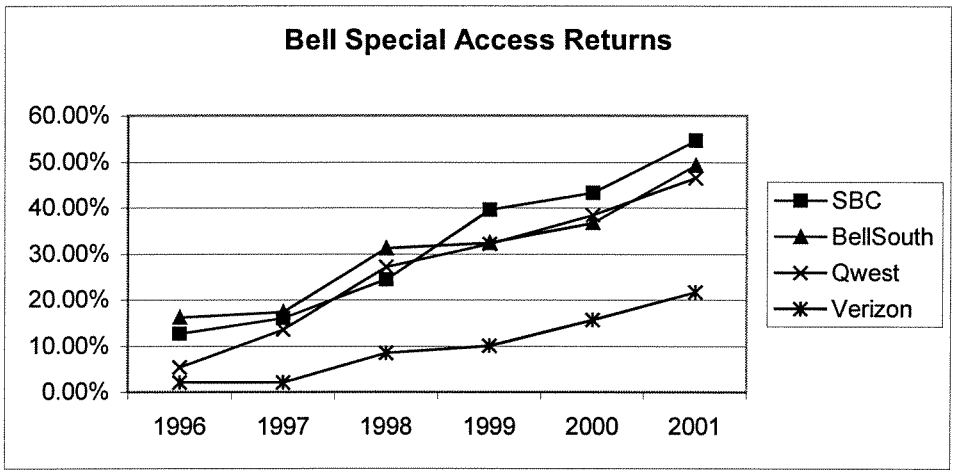
These extraordinarily excessive returns are no aberration; the Bells are fleecing special access customers nationwide, and, by doing so, are reaping shocking windfalls. For example, SBC's special access revenues in 2001 exceeded amounts that would have produced an 11.25% rate of return by an astonishing $2.5 billion. For the same year, Verizon, BellSouth, and Qwest reaped special access windfalls of more than $1 billion, $966 million, and $710 million, respectively. Thus, for 2001 alone, the Bells' excessive special access rates were equivalent to a more than *$5 billion tax* on American businesses.

These patently excessive returns represent conclusive proof of the Bells' overwhelming market power. In fully competitive markets, market forces drive prices toward costs. Costs, of

[5] These rates of return were calculated from 2001 ARMIS 43-01, Table I, Cost and Revenue Table, Column S, Rows 1910 and 1915. *See* Friedlander Dec. ¶¶ 2-4 & Exhibit 1 (Tab A).

course, include the "cost of obtaining debt and equity financing."[6] But in competitive markets, debt and equity investors earn – and a company can pay – only "normal" profits that compensate investors for the riskiness of the investment.[7] That is because any attempt by a firm in a competitive market to charge prices that would allow it to earn more than a normal, risk-adjusted rate-of-return would cause the firm to lose business to other firms that charged prices that reflect the lower level of return that would still be sufficient to induce investment. It is precisely for these reasons that the very definition of monopoly profit is a return in excess of normal profits.[8] And there can be no serious claim that the Bells must earn 50 percent rates of return to attract capital.

The *trend* in the Bells' excess returns for interstate special access is even more alarming. As the following chart demonstrates, the Bells' interstate special access rates of return continue to grow every year, with no exceptions, and with year-to-year increases that are quite remarkable.[9]



[6] *Local Competition Order*, 11 FCC Rcd. 15499, ¶ 700 (1996).

[7] *Id.*

[8] *See* Ordover/Willig Dec. ¶ 23 (Tab B).

[9] *See* Friedlander Dec. ¶ 5 & Exhibit 1.

Moreover, returns calculated from the Bells' ARMIS reports, as high as they are, grossly *understate* the extent of the Bells' special access tax on American consumers and businesses. The costs reported on the Bells' ARMIS reports are, of course, *embedded* costs. And, as the Commission and the courts have consistently recognized, the Bells' true costs of providing services over their local networks are their much lower forward-looking economic costs.[10] The Bells' special access rates exceed their economic costs by enormous margins.

Special access services are provided over the same facilities and are functionally equivalent to high capacity loop and transport unbundled network elements. Yet, the Bells' month-to-month special access rates are generally double or more their comparable UNE rates. The Declaration of Joseph Stith (attached hereto as Tab C) compares the Bells' tariffed interstate special access rates, on a state-by-state basis, with the rates for the functionally equivalent unbundled network elements. For services still subject to price cap regulation, the Bells' month-to-month DS1 and DS3 special access rates are routinely more than 100% higher than the comparable UNE rates, and sometimes they are even 200% or 400% higher. Thus, if the Bells' annual special access returns are calculated on the basis of their *economic* costs, rather than their embedded costs, it becomes clear that their real returns on these monopoly services are astronomical.

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[10] *See, e.g.*, *Local Competition Order* ¶ 679 ("We believe that our adoption of a forward-looking cost-based pricing methodology . . . estabish[es] prices . . . based on costs similar to those incurred by the incumbents."); *Verizon Communications Inc.* v. *FCC*, 122 S. Ct. 1646, 1672 (2002) (costs that exceed TELRIC are inefficient costs); *Alenco Communications Co.* v. *FCC*, 201 F.3d 608, 615 (5th Cir. 2000) ("rates must be based not on *historical, booked costs*, but rather on *forward-looking, economic costs*. After all, market prices respond to current costs; historical investments, by contrast, are sunk and thus ignored.").

In the past, the Bells have attempted to justify the disparity between their special access rates and forward-looking costs by attacking the Commission's "TELRIC" rules, claiming that since special access rates are "competitively disciplined," TELRIC must be considered the problem. In fact, it is the Bells' argument that is flawed. At the outset, it is difficult to conceive how attacking TELRIC could aid the Bells in this context, given that the Bells' special access rates are so plainly excessive even as compared to their preferred embedded cost standard. In any event, the Supreme Court has flatly rejected the Bells' criticisms of TELRIC and has upheld that established forward-looking cost estimation methodology as a fully valid and compensatory method of calculating the Bells' true costs.[11] Indeed, TELRIC is, if anything, *overly* compensatory, given that costs must be calculated on the basis of existing wire center locations and given the inevitable regulatory lag in TELRIC price adjustments.[12] The Bells thus have it precisely backwards: their ability to charge special access rates that are multiples of their forward-looking costs demonstrates that their special access services are *not* subject to any meaningful competitive discipline.

Any possible doubt about the Bells' pervasive market power should be put to rest by the overwhelming evidence that the Bells have, without exception, maintained or even *raised* their special access prices when given flexibility to do so and have had no trouble retaining customers – and, indeed, greatly *increasing* sales – in the wake of those price increases. Beginning in the fall of 2000, the Bells have sought and won pricing flexibility in numerous MSAs. As of the 2002 tariff filings, approximately 59 percent of the Bells' special access revenues (excluding GTE) are no longer subject to price cap regulation. In *every* MSA in which the Bells have

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[11] *See Verizon*, 122 S. Ct. at 1672.

[12] *Id.* at 1670.

obtained this "Phase II" pricing flexibility, they have maintained or even *raised* their rates, which are now consistently above where they would otherwise be under price caps. In particular, if these services had remained subject to price cap regulation, the Bells would have been required to apply substantial X-Factor reductions to these rates in both 2001 and 2002.[13] The elimination of price cap regulation for these services has allowed the Bells to avoid those X-Factor reductions (and to keep rates at pre-pricing flexibility levels), which has deprived access purchasers of over $390 million dollars in rate reductions that they would otherwise have received since the inception of pricing flexibility.[14]

Even more egregiously, both BellSouth and Verizon have increased special access rates in every MSA in which they have been awarded Phase II pricing flexibility. For example, Verizon increased its month-to-month DS1 rates as much as 15% (and its month-to-month DS3 rates by 6%) in *every* MSA in which it won Phase II pricing flexibility, even in large cities such as New York and Boston where the presence of competitors is greatest.[15] Similarly, BellSouth raised its month-to-month DS3 rates by almost 9%, and its DS1 rates by approximately 8%, in each of the MSAs in which it received Phase II pricing flexibility, including such large cities as Atlanta and Miami.[16]

The Commission required price cap LECs to continue to file their rates in tariffs even after receiving Phase II pricing flexibility (*i.e.*, removal from price caps), and therefore it is

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[13] 47 C.F.R. § 61.45(b)(1)(iv).

[14] *See* Stith Dec. ¶ 11. For example, for DS1 term rates – which represent the largest volumes and the largest expense – SBC-Southwestern Bell's pricing flexibility rates are 35% higher than the price cap rates, SBC-Pacific Bell's are 24% higher, Verizon-Bell Atlantic-South's are 16% higher, and Verizon-Bell Atlantic-North's are 7% to 14% higher (depending on the state).

[15] Verizon Transmittal No. 134 (December 21, 2001).

[16] BellSouth filed Transmittal No. 608, effective November 1, 2001, increasing Special Access rates for DS3 and DS1 services in MSAs with Phase II pricing flexibility.

possible to compare the Bells' tariffed Phase II rates with their price capped rates in each state. The tariffed rate in Phase II MSAs no longer subject to price cap regulation is equal to or higher than the rate for the same service in areas that remain subject to price cap regulation for virtually *every* special access service in *every* state for *every* Bell.[17]

The Bells' only defense of this naked exercise of monopoly power has been to seize on the Commission's speculation in the *Pricing Flexibility Order* (¶ 155) that "some access rate increases may be warranted, because our rules may have required incumbent LECs to price access services below cost in certain areas." But such a claim is obviously unsustainable in light of the Bells' grossly excessive rates of return. In light of the facts, the notion that price caps were holding the Bells' rates below costs is preposterous. Indeed, even though the Bells' rates of return were *already* excessive when they were awarded pricing flexibility, it is striking that after most special access has now been removed from price caps, the Bells have not seen fit to respond to competition by lowering their rates in *any* of those MSAs.[18]

These rate increases are particularly anticompetitive, because the areas in which the Bells have obtained Phase II deregulation tend to be the more densely populated areas and thus would typically be characterized by costs that are *lower* than those in the areas in which the Bells have not received pricing flexibility. The fact that the Bells' rates are consistently higher in the lower cost areas is vivid proof that the Bells retain overwhelming market power in every local market, including those with the most competitive activity.

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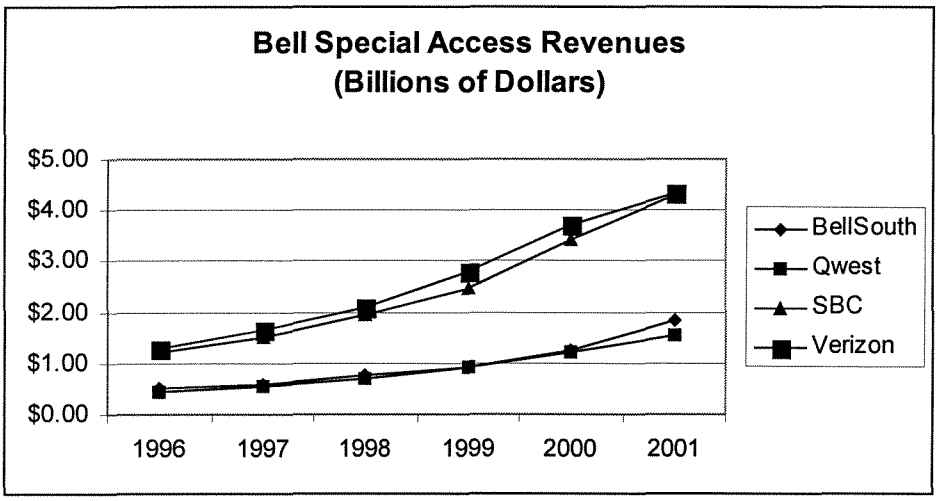
[17] The only exception is Ameritech's rates for OC-3; the pricing flexibility rate is one percent lower than the price cap rate. The chart attached to the Stith Declaration is based on each Bell's rates as of August 1, 2002, and each price is calculated as a ten mile stand-alone circuit in order to facilitate apples-to-apples comparisons. If the distance were changed from ten miles to five miles, the pricing flexibility rate would be higher even for Ameritech's OC-3 service.

[18] *See* Ordover/Willig Dec. ¶ 30.

At the same time that the Bells have been increasing already above-cost access charges, IXCs and other competitive local carriers have been increasingly forced to rely on the Bells' access services, even to provide competitive local services. This can be seen most directly in the dramatic increase in the Bells' special access revenues. Specifically, special access revenues of the Bells have more than tripled since 1996, from $3.4 billion to $12.0 billion. Once again, this trend holds true for all of the Bells and has been very consistent from year to year; indeed, if anything the trend has become more pronounced in recent years.[19]



Of course, if last mile alternatives to the Bells' facilities truly existed, the Bells would not be able to impose staggering rate increases and simultaneously increase overall usage of their networks. Nor have carriers been able to use UNEs to bypass the Bells, as Congress intended. As AT&T has explained in detail in the Triennial UNE Review Proceeding, because of the Commission's use and commingling restrictions on enhanced extended links ("EELs"), IXCs and competitive carriers must rely on Bell special access in order to provide both exchange access

[19] *See* Friedlander Dec. ¶ 7 & Exhibit 2.

and local service.[20] Thus, competitive entry into the local market has had the perverse effect of swelling the Bells' special access revenues (and thus their excessive earnings).

The Bells' abysmal performance in provisioning their special access services even as they continue to raise their special access rates further confirms the Bells' continuing market power and the need for immediate reform of rate regulation.[21] The Joint Competitive Industry Group, which represents the entire spectrum of purchasers of special access (including non-carrier end-user customers), has documented the Bells' patently unacceptable performance and proposed specific performance metrics and other remedies. The fact that customers, including end-user customers, stay with the Bells in the face of both widespread service problems and excessive rates, is conclusive proof that customers rarely have alternative suppliers.[22]

In sum, in enacting the pricing flexibility regime, the Commission recognized that pricing flexibility could be lawful only to the extent that "price cap LECs do not increase rates to unreasonable levels for customers that lack competitive alternatives."[23] But the indisputable evidence now shows that price cap LECs *are* increasing rates to unreasonable levels for customers that lack competitive alternatives. The Commission cannot allow this situation to continue. The Commission's prime directive is to protect the public interest by ensuring that telecommunications services are provided "at reasonable charges."[24] By any measure, the Bells'

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[20] *See* Comments of AT&T Corp., CC Docket No. 01-338 *et al.*, at 136-40 (filed April 5, 2002) ("AT&T Triennial Review Comments"); Reply Comments of AT&T Corp., CC Docket No. 01-338, at 283-300 (filed July 17, 2002) ("AT&T Triennial Review Reply Comments").

[21] *See Performance Measures and Standards for Interstate Special Access Services*, CC Docket No. 01-321, Notice of Proposed Rulemaking (rel. Nov. 19, 2001); *id.*, Comments of AT&T, filed January 22, 2002.

[22] *See* Ordover/Willig Dec. ¶ 31.

[23] *Pricing Flexibility Order*, 14 FCC Rcd. 14221, ¶ 3 (1999).

[24] 47 U.S.C. § 151.

special access charges exceed lawful levels by billions of dollars. Although this special access tax undoubtedly benefits the Bells, it inflicts great harm on the public and is an enormous drag on the U.S. economy.

II. THE BELLS' UNLAWFUL SPECIAL ACCESS RATES ARE HAVING SEVERE AND GROWING ANTICOMPETITIVE EFFECTS.

The Bells' "creamy returns" alone require the Commission to reform its regulation of the Bells' special access rates.[25] But regulatory reform is also necessary to prevent the Bells from using their control of bottleneck network facilities to raise rivals' costs, to foreclose the development of local competition, and to impede long distance competition. Given the fragility of emerging local competition and the recent entry of the Bells into the long distance market, there is an urgent need to foreclose this anticompetitive conduct.

A. The Bells' Excessive Special Access Rates Impede The Ability Of CLECs To Self-Deploy Alternative Transmission Facilities.

The Bells' bloated access charges create an enormous local entry barrier. As described in greater detail in Part III below, there are generally no alternatives to the Bells' last mile transmission facilities, even high-capacity loops and transport facilities. Thus, competitive carriers that seek to self-deploy switches are critically dependent upon incumbent transmission facilities to connect customer locations to their switches.

Competitive carriers also need access to Bell transmission facilities as a "bridge" mechanism to self-deploying their own transmission facilities in the few instances where it is theoretically economic to do so. The reasons for this are quite simple. Given the sunk cost nature of transmission facilities, competitive carriers simply cannot build transmission facilities

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[25] *Farmers Union II*, 734 F.2d at 1502-03; *Illinois Bell Tel. Co.* v. *FCC*, 988 F.2d 1254, 1260 (D.C. Cir. 1993). *See also Potomac Elec. Power Co.* v. *Public Utils. Comm'n of the District of Columbia*, 158 F.2d 521, 527 (D.C. Cir. 1947) (*quoting Dayton-Goose Creek R. Co.* v. *United States*, 263 U.S. 456, 483 (1924)).

"on spec" and hope that customers will show up. Rather, they need some reasonable assurance that there is sufficient demand to support a deployment of transmission facilities. *USTA* v. *FCC*, 290 F.3d 415, 424 (D.C. Cir. 2002) ("access to UNEs may enable a CLEC to enter the market gradually, building a customer base up to the level where its own investment would be profitable."). Customers, on the other hand, are understandably not willing to commit to service and then wait the many months (and in some cases, years) that it takes to secure the necessary rights-of-way and build transmission facilities.[26]

The availability of UNEs could mitigate these entry barriers by allowing a CLEC to win customers immediately by purchasing access to incumbent network facilities and then to construct the transmission facilities to serve its growing customer base. In its *Supplemental Order* and *Supplemental Order Clarification*, however, the Commission permitted incumbents to impose "use" and "commingling" restrictions on combinations of unbundled loops and transport facilities that have prevented CLECs from converting special access services into unbundled network elements in all but the most unusual circumstances.[27] Thus, the only alternatives available to CLECs are the Bells' special access services. As a result, over 98% of AT&T's facilities-based *local* service for business customers using incumbent facilities of DS-1 level or higher is provided over incumbent special access services, not UNEs.[28]

Meaningful facilities-based competition is simply not possible under these conditions. As explained above, special access rates are typically twice (and sometimes three or four times) the TELRIC rates for the comparable UNEs. Because TELRIC measures the incumbent's true

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[26] *See infra* Part III.A.

[27] Comments of AT&T Corp., CC Docket No. 96-98, at 18-23 (filed April 5, 2001) ("AT&T Use Restriction Comments"); AT&T Triennial Review Reply Comments at 283-300.

[28] *See* AT&T Triennial Review Reply Comments at 283 & Pfau Reply Dec. ¶ 26 n.10.

economic costs,[29] the fact that access rates are twice TELRIC means that the CLEC's cost of accessing the underlying facilities is usually twice (or more) that of the incumbent. And a competitive carrier generally cannot justify constructing its own transport facilities unless it can aggregate traffic from numerous LSOs to a hub, and then place the aggregated traffic onto its own transport facilities at the hub.[30] CLECs are thus forced into a Hobson's Choice: they can either pay excessive special access rates to reach those additional LSOs and thereby internalize a cost structure that will not allow them to compete effectively with the Bells, or they can attempt to build fiber facilities with enormous excess capacity and substantial up front costs that would dwarf the reasonably anticipated revenue stream. In either case, these costs – which the Bells do not face – are true barriers to entry that simply foreclose broader facilities-based competition.

B. Existing Regulation Permits The Bells To Target Their Market Power.

The competitive damage permitted under the existing rules goes well beyond allowing the Bells to charge excessive prices for critical inputs that serve as a necessary bridge or complement to facilities deployment. The Bells' ability to engage in discriminatory contract tariffs is equally pernicious, because it allows the Bells surgically to foreclose competition. In particular, the existing pricing flexibility rules permit the Bells to price discriminate in order to prevent entry or drive competitors out of the market and to use long term contracts to deny competitors access to the traffic necessary to justify facilities deployment.

The Existing Regulations Permit The Bells To Engage In Exclusionary Pricing Behavior. It has been noted that the Bells' grossly excessive special access rates create a "price umbrella"

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[29] *Local Competition Order* ¶ 679.

[30] *See* AT&T Triennial Review Reply Comments at 251-52.

for CLECs that deploy alternative facilities. However, as Professor Willig has explained, the sunk cost nature of investment in transmission facilities means that

> reliance on the existence of this pricing umbrella . . . is very risky. To the extent that an ILEC can price discriminate, it will be able to lower prices selectively, only to those customers that could potentially be served by the new entrant and keep prices high for all other customers. For example, if a competitive carrier were to deploy transport facilities between two points, an ILEC could respond by lowering prices on that route but not any others. Also, the price umbrella could be collapsed by the possible future entry of *other* CLECs. Thus, even if a CLEC can be reasonably sure that prices will remain stable in the near term after entry, to be successful over the long term, it must enter at costs comparable to the ILEC's because there remains a significant risk that the ILEC will ultimately choose to lower its prices down towards its costs.[31]

The Commission in its *Pricing Flexibility Order* (¶ 79) was "concerned" about this precise point. The Commission observed that "Phase I relief, which enables [the Bells] to offer contract tariffs to individual customers, [could permit the Bells] to engage in exclusionary pricing behavior." *Id.* In particular, the Commission observed that, absent regulation, the Bells had the ability to "reduce prices in the short run and forgo current profits in order to prevent the entry of rivals or to drive them from the market." *Id.* Indeed, because the Bell almost always enjoys substantial advantages over the CLEC in terms of per-unit costs, the Bell can reduce its rates to a point between its own unit cost and that of the CLEC at any time. As a result, the Bell can drive any CLEC from the market to the extent the CLEC's business plan is based on being able to charge prevailing supracompetitive access prices.[32]

The Commission found that these concerns would be addressed by its decision to grant downward pricing flexibility only where CLECs had made "substantial sunk investment." *Id.* ¶ 80. The Commission reasoned that where investment in alternative facilities had been sunk, the

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[31] AT&T Triennial Review Reply Comments, Willig Reply Dec. ¶ 25.

[32] *See* AT&T Triennial Review Reply Comments, Lesher Reply Dec. ¶ 28.

Bells would have no incentive to engage in exclusionary behavior because there would be little prospect of driving the CLECs out of the market. "If a competitive LEC has made a substantial sunk investment in equipment, that equipment remains available and capable of providing service in competition with the incumbent, even if the incumbent succeeds in driving that competitor from the market." *Id.*

Experience now shows that the Commission's belief that its pricing flexibility triggers "measure the extent to which competitors have made sunk investment in facilities used to compete with the incumbent LEC" was erroneous. For example, the trigger for deregulation of dedicated transport is inherently flawed, because it focuses only on whether there is *some* fiber deployed in a collocation, and not whether the CLEC's transport facilities fully bypass the Bell's transport facilities. Indeed, as the Commission itself noted in the *Pricing Flexibility Order* (¶ 81), most transmission facilities in a collocation are trunk-side "facilities leading from the collocated equipment to the IXC POP." As a result, the Commission's dedicated transport trigger deregulates the Bell's transport rates, even though the CLEC has bypassed only one of the transport links included in that service – the Bell's entrance facilities. The triggers for channel terminations are even less representative of the existence of relevant sunk investment, because they rely exclusively on a showing of *transport* deployment as evidence of loop deployment.[33] Under this test, a Bell can receive deregulation of its channel termination rates without showing that CLECs have deployed a single loop anywhere in the MSA. In other words, the collocation trigger identifies only the possibility of competitive facilities between the collocation cage and

[33] This is rather like deregulating the rates for first class mail because there is competition for overnight deliveries under the "trigger" that post offices are used in the delivery of both overnight mail packages and first class mail. In effect, the existing special access pricing flexibility triggers allow deregulation of "first class mail" (here, transport and customer channel terminations) because there is competition for "overnight packages" (entrance facilities) through

the competitor; it says nothing about the potential for competition between the collocation cage and the customer – *i.e.*, interoffice transport and loop equivalent facilities.[34]

The Commission's "percentage of revenues" trigger is especially pernicious. The Commission offered the Bells two alternative triggers: they could demonstrate "fiber-based collocations" in a certain percentage of the wire centers in an MSA, *or* they could show fiber-based collocations in wire centers representing a certain percentage of the Bell's revenues from the relevant services in that MSA. The "percentage of revenues" test usually means that the Bell need only demonstrate facilities-based collocations in an even smaller percentage of wire centers (*i.e.*, those in the most urban area of the MSA), and – not surprisingly – the Bells have relied almost exclusively on that alternative trigger in winning pricing flexibility all over the country.

The Existing Rules Permit The Bells To Engage In Customer Foreclosure. As the Commission recognized in its *Pricing Flexibility Order*, the Bells can prevent facilities competition by engaging in customer foreclosure. In particular,

> [a]n incumbent can forestall the entry of potential competitors by "locking up" large customers . . . . Specifically, large customers may create the inducement for potential competitors to invest in sunk facilities . . . . To the extent the incumbent can lock in the larger . . . customers whose traffic would economically justify the construction of new facilities, the incumbents can foreclose competition for the smaller customer as well.[35]

It is now clear that the existing rules do not prevent this type of exclusionary conduct. The Bells are using their market power to force carriers to enter into anticompetitive optional pricing plans ("OPPs") that remove even the possibility that market forces could constrain the

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the use of the collocation cages (post offices).

[34] This is especially problematic because entrance facilities represent a relatively small percentage of the overall cost of special access (typically around 15 percent).

[35] *Pricing Flexibility Order* ¶ 79.

Bells' market power. The Bells have threatened IXCs with even higher rates unless they sign long-term contracts with huge penalties for early termination. Carriers have agreed to these OPP deals, because of the urgent need to cut access expense (or, at least, to keep it from rising even further).

These OPPs are severely anticompetitive. For example, virtually all of these plans require AT&T to commit to certain levels of annual purchases to obtain the discounts. As a result, if AT&T were to migrate even a relatively small portion of its traffic to its own or Bell competitors' facilities, it would lose the OPP discounts (typically on a *regionwide* basis), which in most cases would dwarf whatever savings AT&T could achieve by using competitive alternatives. Indeed, some Bells have insisted on specific penalties for migrating traffic to competitors.[36] And even if more broadly available alternatives were to become available – *e.g.*, if the Commission were to eliminate use restrictions on EELs or if broad-based facilities-based alternatives were somehow to emerge – AT&T could not take advantage of them in many cases, because virtually all of these OPP plans impose substantial penalties for early withdrawal, which would negate any savings.[37] Moreover, as the Commission recognized in the *Pricing Flexibility Order*, long term contracts can also prevent entry because the Bells have locked up the largest

[36] For example, SBC's Managed Value Plans require that, to the extent AT&T meets its special access needs over SBC facilities (as it overwhelmingly must), it must use UNEs to provision no more than 5% of those needs, and it must meet 95% or more of those needs using SBC special access. Similarly, Qwest's plans require AT&T to pay 125% of the remaining value of the OPP for circuits that are converted to UNEs. And Verizon's plans condition discounts for DS1 services on expanded commitments to purchase DS3 services.

[37] For example, SBC's Managed Value Plans require forfeiture of the previous six months' credits plus anywhere from 20% to 40% of the monthly revenue commitment for the remainder of the term of the agreement. Qwest imposes termination penalties of 100% of the recurring expense for the first remaining year plus 50% of the recurring expense for all other remaining years.

special access customers, thereby depriving competitive carriers of the traffic and revenues necessary to fund construction of bypass facilities.[38]

C. The Bells' Excessive Special Access Rates Are Having An Increasingly Anticompetitive Impact On The Long Distance Market.

The Bells' excessive special access rates also are having an increasingly anticompetitive effect in the long distance market, as the Bells win interLATA authority. Access is a "necessary input for long-distance service" and access charges constitute a sizeable percentage of the overall cost of long distance services.[39] This gives the Bells the opportunity to undertake a classic strategy of raising rivals' costs.[40]

> Absent appropriate regulation, an incumbent LEC and its interexchange affiliate could potentially implement a price squeeze once the incumbent LEC began offering in-region, interexchange toll services. . . . The incumbent LEC could do this by raising the price of interstate access services to all interexchange carriers, which would cause competing in-region carriers to either raise their retail rates to maintain their profit margins or to attempt to maintain their market share by not raising their prices to reflect the increase in access charges, thereby reducing their profit margins. If the competing in-region, interexchange providers raised their prices to recover the increased access charges, the incumbent LEC's interexchange affiliate could seek to expand its market share by not matching the price increase. The incumbent LEC affiliate could also set its in-region, interexchange prices at or below its access prices. Its competitors would then be faced with the choice of lowering their retail rates for interexchange services, thereby reducing their profit margins, or maintaining their retail rates at the higher price and risk losing market share.[41]

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[38] The Commission has previously ordered the Bells not to apply termination penalties in similar circumstances. *See Local Exchange Carriers' Individual Case Basis DS3 Service Offerings*, CC Docket No. 88-136, 4 FCC Rcd. 8634, ¶ 79 (1989) (in ordering LECs to convert all individual case basis pricing for DS3 services to generally available rates, the Commission found that "we will not permit LECs to assess converted ICB customers termination liability charges or non-recurring charges").

[39] *Access Reform Order*, 12 FCC Rcd. 15982, ¶ 275 (1997).

[40] *See generally Premier Elec. Constr. Co.* v. *National Elec. Contractors Ass'n*, 814 F.2d 358, 368 (7th Cir. 1987) (citing T. Krattenmaker & S. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 Yale L.J. 209 (1986)).

[41] *Access Reform Order* ¶ 277.

The Commission's *Access Reform Order* made the predictive judgment that "appropriate regulation" was in place to prevent such anticompetitive price squeezes. But in so holding, the Commission relied on both the existence of price cap regulation to "limit[] the ability of LECs to raise the prices of the input services,"[42] and the availability of UNEs that would allow "rival long-distance providers" to "purchase unbundled network elements" as substitutes for Bell-provided access.[43] The *Pricing Flexibility Order* gutted the "limit" imposed by the price cap regime, and the *Supplemental Order* and *Supplemental Order Clarification* foreclosed IXCs from using UNEs for access.

The evidence confirms that the Bells not only can but have undertaken such price squeezes. For example, BellSouth offers an intrastate service in its region called "Fast Packet Option." Under this offer, end users can obtain special access at rates that are lower than those in BellSouth's federal tariffs, but only if the end user agrees to purchase BellSouth's frame relay services as well.[44] As a result, AT&T cannot obtain special access at the "Fast Packet Option" rates and pair that service with its own frame relay services. The Bells' grossly excessive special access rates easily facilitate such blatant price squeezes, and the dangers of such price squeezes will only increase as the Bells' continue to win interLATA authority under Section 271.[45]

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[42] *Id.* ¶ 276.

[43] *Id.* ¶ 280; *see also Bell Atlantic NYNEX Merger Order*, 12 FCC Rcd. 19985, ¶ 117 (1997).

[44] *Compare* BellSouth Telecommunications Inc., Georgia, General Subscriber Service Tariff, Twelfth Revised Page 1, A.40 (Frame Relay Service), *with* BellSouth Telecommunications, Inc., Tariff FCC No. 1, 6th Revised page 21-1 (Fast Packet Access Services). BellSouth has similar tariffs in each of the states in its region.

[45] *See* Ordover/Willig Dec. ¶¶ 62-67.

III. NEITHER MARKET FORCES NOR THE COMMISSION'S EXISTING SPECIAL ACCESS RATE REGULATION CAN CONCEIVABLY ADDRESS THESE MARKET POWER ABUSES.

The only way to combat the Bells' excessive special access rates is to reform rate regulations. The problem will not solve itself, because there are not (and will not be for the foreseeable future) sufficient competitive alternatives to constrain the Bells' special access pricing. And it is equally clear that the Commission's existing regulatory regime does not provide such constraints; indeed, the current regime is exacerbating the problem by facilitating the removal of even the inadequate constraints provided by price caps.

A. Market Forces Cannot Constrain Bell Prices, Because IXCs and CLECs Generally Have No Choice But To Purchase Special Access From The Bells.

As explained above, the Bells have been able both to grow the special access traffic that they carry on their networks and to maintain poor provisioning and performance even as they increase their special access service rates. This is because, in the vast majority of cases, there are no alternatives to the Bells' special access services. That is unlikely to change soon, because building alternative loop and transport facilities is, in most instances, fundamentally uneconomic. And even if that were not the case, the Bells have locked carriers into long term special access contracts, thereby ensuring that IXCs and CLECs will remain captives of the Bells for at least the next several years.

1. Competitive Carriers Can Self-Supply Or Use Third Party Facilities-Based Special Access Only In Very Unusual Circumstances.

Despite billions of dollars in investments, AT&T has been able to replicate only a small fraction of the Bells' high-capacity networks. Even in those limited instances where AT&T has deployed a fiber ring, it still relies on the Bell to provide both "tails" from customers' premises to AT&T's fiber ring and "backbone" transport used to carry traffic to hubs where it can be aggregated and then carried on AT&T's fiber ring. For the "backbone" portion of AT&T's own

local network, AT&T almost never self-provides DS-1 transport and self-provides DS-3 transport only a small proportion of the time.[46] Likewise, for the "tail" portion of the network, AT&T provides a very small fraction of its own DS-1 facilities.[47] The remaining service is provided almost entirely by utilizing the facilities of the Bells.[48] And even in instances in which AT&T has established connectivity to a building, landlords frequently limit AT&T to a "fiber to the floor" arrangement – *i.e.*, AT&T can serve only a particular customer with its own facilities, and not other customers in the same building.[49]

AT&T also has severely limited opportunities to expand its use of facilities-based alternatives. As explained in the attached declaration of Ken Thomas (Tab D), AT&T's long distance unit has a team charged with finding and negotiating alternative access arrangements. This team's data demonstrate, however, that CLECs have established alternative facilities to only a tiny fraction of buildings. AT&T has contractual arrangements with virtually all of the major CLECs that offer facilities-based access services, such as MFS/WorldCom, Adelphia, and Time Warner. These CLECs, however, can provide access to only a small minority of additional buildings nationwide.[50]

Moreover, even where AT&T has a contractual arrangement with a CLEC, AT&T often cannot use that CLEC to provide access, for at least three important reasons. First, many CLECs have overstated the extent to which they have buildings "on-net." AT&T has contractual arrangements with all of the major CLECs for the right to purchase special access services to any

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[46] AT&T Triennial Review Reply Comments, Fea-Giovannucci Dec. ¶ 58.

[47] *Id.* ¶ 68.

[48] *Id.* ¶¶ 58, 68.

[49] AT&T Triennial Review Reply Comments, Fea-Giovannucci Dec. ¶¶ 59-68.

[50] *See* Thomas Dec. ¶¶ 6-7.

buildings in which they have facilities. Although many of these CLECs initially represented that they had a certain number of buildings "on-net," it became clear later that, in many cases, the CLECs actually relied on the *Bell's* special access services to reach the building.[51]

Second, most of the major CLECs that provide alternative access are bankrupt, which has greatly diminished the ability of AT&T to use their services. Indeed, most of the buildings available to AT&T that are served by CLECs are served by Adelphia, WorldCom, and other companies in bankruptcy.[52] A carrier cannot assume that a bankrupt supplier will remain in business and continue to provide uninterrupted service. AT&T has faced numerous situations in recent months in which the continued availability of supply from one of AT&T's third party suppliers has been thrown in doubt, and AT&T has had to expend considerable resources to ensure that a backup source of supply would be available.[53] And even if AT&T had confidence in these carriers, AT&T's customers do not. As Mr. Thomas explains, potential customers are increasingly insisting that AT&T not rely on bankrupt (or potentially bankrupt) CLECs for any part of its service.[54]

Third, capacity on CLECs' networks is also often expensive, because CLECs typically provide only a modest discount off of the price umbrella of the Bells' special access services.[55] Moreover, use of a wholesaler's network often requires inefficient routing, and physically interconnecting with wholesalers' facilities often poses costly logistical and other practical problems that the ILECs typically do not face because of their large and integrated networks.

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[51] *See id.* ¶ 8.

[52] *See id.* ¶ 9; *see also* AT&T Triennial Review Reply Comments, Fea-Giovannucci Reply Dec. ¶ 55.

[53] *See* AT&T Triennial Review Reply Comments, Fea-Giovannucci Reply Dec.¶¶ 55-56.

[54] *See* Thomas Dec. ¶ 10.

[55] *See id.* ¶ 11.

In short, AT&T must rely on the incumbent in the vast majority of cases. As Mr. Thomas shows, AT&T has a theoretically available, facilities-based alternative in only about five percent of the buildings in which AT&T purchases special access. And even that figure overstates the availability of alternatives, because CLEC bankruptcies, "fiber to the floor" arrangements, and similar restrictions render many of even these buildings (or portions of these buildings) unavilable to AT&T.

AT&T's experience is confirmed by the findings of the state commissions that have undertaken investigations of special access services. As the New York PSC has found, Verizon's network serves 7354 buildings in LATA 132 (Manhattan) over fiber while CLECs serve fewer than 1000 buildings.[56] Indeed, the New York PSC recently reaffirmed that "Verizon continues to be the dominant provider of high-capacity loops used to provide service to large volume customers," and that "[e]ven in lower/midtown Manhattan, Verizon facilities (retail and wholesale) still serve over half of all special service circuits."[57] Similarly, the Massachusetts DTE recently held that strict rate regulation of Verizon's intra-LATA special access service was necessary to protect competition.[58]

2. Self-Deployment Of Alternative Facilities To Provide Special Access Is Infeasible In Most Cases.

This clear lack of facilities-based alternatives to Bell special access will not change in the foreseeable future. The record from the Triennial UNE Review Proceeding demonstrates that, because of basic economic and network engineering considerations, competitors will be able to

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[56] *Opinion and Order Modifying Special Services Guidelines for Verizon New York Inc., Conforming Tariff, and Requiring Additional Performance Reporting*, Case Nos. 00-C-2051, at 7 (NYPSC June 15, 2001).

[57] Comments of New York Department of Public Service, CC Docket 01-338 *et al.*, at 5 (filed April 5, 2002).

[58] Order, DTE 01-31-Phase I (Mass. DTE May 8, 2002).

deploy alternative facilities in only limited circumstances. Loop and transport facilities are characterized by enormous economies of scale and sunk costs. Thus, in most instances, replicating incumbent transmission facilities would be economically wasteful. And even in those few instances where self-deployment can be economically justified, barriers to entry such as the inability to obtain necessary rights-of-way in a timely fashion often prevent competitive deployment of facilities.

Transmission Facilities Are Characterized By Enormous Economies Of Scale. Most of the cost of deploying loops, including "high capacity" loops, is in the supporting structures, placement, rights of way, and access to buildings, and not in the conductors (fiber strand or copper wires) themselves. Because the costs of supporting structures are relatively insensitive to the number of wires of fiber deployed, the Bells enjoy substantial economies of scale.[59]

Dedicated transport is also characterized by enormous economies of scale and scope.[60] Not only do the Bells have fiber interconnecting virtually all of their LSOs (either directly or indirectly), they also generally deployed dark fiber capacity at the time of the initial facility construction, so they can dramatically increase capacity on most routes simply by adding terminating electronics at relatively minimal incremental costs (and certainly at a trivial cost compared to new construction). Thus, even on specific, high-demand point-to-point routes, a CLEC cannot hope to achieve the per-unit cost of the Bells' transport.[61]

Transmission Facilities Are Characterized By Substantial Sunk Costs. The difficulties in self-deploying transmission facilities in competition with incumbents are exacerbated by the fact that costs to construct loop and transport facilities are sunk. An investment is sunk if, once

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[59] AT&T Triennial Review Reply Comments, Fea-Giovannucci Dec. ¶¶ 6-8.

[60] *Id.* ¶ 8.

[61] *See* Ordover/Willig Dec. ¶ 40-41.

made, it cannot be re-deployed for some other use.[62] Investments spent on trenching, structure, and rights of way for a loop clearly fall into this category. It is basic economics that the need to incur significant sunk costs to deploy facilities that have substantial scale economies establishes a significant entry barrier.

When investments must be sunk, an entrant will be hesitant to undertake an investment if there is a substantial risk that it will not be able to recover the costs of the investment. As Professor Willig has explained:

> The reasoning for this is straightforward. If costs are sunk, the potential entrant knows that it will not be able to recover its costs if it is unable to attract sufficient revenues to recover the sunk costs. At the same time, because of economies of scale, the new entrant will incur higher per-unit costs, making it difficult for it to win sufficient customers away from the incumbent. Further, because the incumbent has already sunk its costs and has very low marginal costs, there is a significant threat that the incumbent could drop its prices in response to competitive inroads at any time down to its short run costs.[63]

There is broad agreement in the economics community that industries characterized *both* by declining average costs *and* sunk costs are generally natural monopolies.[64] Thus, even if an entrant could reasonably approximate the scale economies of the incumbent, the existence of sunk costs and the threat that the incumbent would respond with rock-bottom prices may deter all but targeted, limited entry – a point that the Commission has repeatedly recognized.[65]

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[62] See Third Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 15 FCC Rcd. 3696, ¶ 75 (1999) ("*UNE Remand Order*").

[63] AT&T Triennial Review Comments, Willig Reply Dec. ¶ 21.

[64] William J. Baumol, John C. Panzar, and Robert D. Willig, CONTESTABLE MARKETS AND INDUSTRY STRUCTURE (Harcourt Brace Jovanovich, Inc., 1982); Dennis W. Carlton and Jeffrey M. Perloff, MODERN INDUSTRIAL ORGANIZATION (3rd ed. Addison Wesley, 2000).

[65] *See Section 257 Report*, 12 FCC Rcd. 16802, ¶ 18 n.48 (1997) ("If entry into an industry requires large sunk costs, the firm that incurs these sunk costs first (the incumbent) can have a tremendous advantage. Potential new entrants may realize that any large scale facilities-based entry into the market will probably force prices to decrease and those prices may be in fact below the point necessary to recover the sunk cost investment. As a result, facilities-based entry will be

CLECs Face Enormous Real-World Entry Barriers. Finally, the Bells enjoy a first mover advantage over any CLEC that is often dispositive. This creates a substantial entry barrier in the classic sense, for CLECs must bear costs that the Bells did not. George J. Stigler, THE ORGANIZATION OF INDUSTRY 67 (1968) (an entry barrier is "a cost of producing (at some or every rate of output) which must be borne by a firm which seeks to enter an industry but is not borne by firms already in the industry"); *see also Bell Atlantic-NYNEX Merger Order*, 12 FCC Rcd. 19985, ¶ 129 n.247 (1997) (same).

As first movers, the Bells received rights-of-way from local governments for underground cables and telephone poles and wires with only minimal transaction costs, because persons in the neighborhood or municipality otherwise would not receive *any* telecommunications services. Similarly, building owners and landlords welcomed Bells that promised to bring, for the first time, telecommunications facilities to their properties. As subsequent entrants, CLECs, on the other hand, generally cannot rely on existing facilities, rights of way, or conduit.[66] Rather, CLECs must construct the loops and transport from scratch, which inevitably takes many months of pre-construction while the CLEC negotiates and secures (if possible) the necessary rights of way and construction permits from the municipality and negotiates terms of building access from the landlord.[67] Rather than welcoming additional competition, these entities often view CLEC requests for rights-of-way as a nuisance. Customers understandably do not wish to wait the many months necessary for the competitive carrier to negotiate this thicket, and they usually choose the Bell instead. For all of these reasons, there is

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deterred."); *see also MCI-BT Merger Order*, 12 FCC Rcd. 15351, ¶ 162 (1997) (same).

[66] AT&T Triennial Review Reply Comments, Fea-Giovannucci Dec. ¶¶ 11, 31.

[67] *Id.* ¶¶ 32-42.

no sustainable basis to conclude that the special access crisis will solve itself or that new entry can be relied upon to constrain the Bells' special access rates.[68]

B. The Existing Regime of Special Access Rate Regulation Is Exacerbating the Problem.

Nor can existing rate regulation solve these fundamental problems. To the contrary, the Bells have been able to charge supracompetitive special access rates not because of lack of enforcement of the Commission's pricing regulatory regime, but because that regime is patently inadequate to prevent the exercise of the Bells' market power.

Prior to the 1990s, the Commission regulated special access rates using traditional rate-of-return regulation. In 1991, the Commission adopted a "price cap" regime, which imposed a "cap" on the aggregate prices charged by Bells for certain services, including special access services. The price cap regime originally contained numerous protections for consumers, such as the "sharing" mechanism (which required price cap reductions if the Bells' rates of return exceeded a certain threshold) and the X-Factor (which required annual reductions for anticipated gains in productivity). Indeed, it is worth noting that the threshold for 100% sharing under the Commission's previous rules was never higher than 17.25%. Over the years, however, the Commission gradually relaxed and then eliminated the sharing mechanism.

In 1999, the Commission adopted the *Pricing Flexibility Order*, which established a procedure to permit price cap LECs to remove special access services from price cap regulation altogether. Under the *Pricing Flexibility Order*, a Bell need not demonstrate that competitive conditions would warrant such radical deregulation; instead, the Bell need only satisfy certain bright-line "triggers." For special access services, a Bell can obtain complete elimination of price cap regulation in a given MSA – which is known as "Phase II" pricing flexibility – if it can

[68] *See* Ordover/Willig Dec. ¶¶ 43-45.

show that a certain percentage of the wire centers in that MSA have at least one collocator that is using non-ILEC transport facilities.[69]

When it adopted the *Pricing Flexibility Order*, the Commission freely acknowledged that the price cap LECs would remain dominant carriers with market power even after receiving Phase II relief.[70] The Commission nonetheless predicted that market forces would prevent the Bells from abusing that market power.[71] That prediction has now been proven wrong. The Bells have used pricing flexibility to do precisely what the Communications Act is designed to prevent – they have strategically raised rates to reap monopoly profits and to impede competition.

IV. THE COMMISSION CANNOT LAWFULLY STAND ON THE SIDELINES WHILE THE BELLS CONTINUE TO EXPLOIT THEIR MARKET POWER OVER SPECIAL ACCESS.

It is well settled that Sections 201 and 202 of the Communications Act provide the Commission with ample authority to address the Bells' monopoly abuses[72] and responsibility to choose the appropriate method of doing so – ranging from strict cost-based rate of return regulation to an overhaul of the current price cap regime.[73] To the extent that such measures

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[69] *See Pricing Flexibility Order* ¶¶ 141-57.

[70] *See Pricing Flexibility Order* ¶¶ 90, 151.

[71] Indeed, the Commission predicted that the Bells would lower their rates. *See* News Release, Report No. 99-33 (August 5, 1999) ("These reforms will enable [the Bells] to compete more efficiently, and customers of interstate access services should benefit from increased choices among carriers and lower overall rates"; the order ensures against "unreasonable rate increases for customers without competitive alternatives").

[72] *See, e.g., Promotion of Competitive Networks in Local Telecommunications Markets, et al.*, First Report And Order and Further Notice of Proposed Rulemaking, 15 FCC Rcd 22983, ¶ 134 (2000) ("It is well established that the Commission has broad authority to regulate the practices of LECs in connection with their provision of interstate communications services. In addition to the general authority specified in Title I of the Communications Act, Title II [and in particular §§ 201 and 202] provides a specific, substantive framework for the Commission's regulation of such practices.").

[73] *See, e.g., Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968); *FERC* v. *Pennzoil Producing Co.*, 439 U.S. 508, 517 (1979).

arguably entail a "change of mind" by the Commission, such a change does not remotely "render the agency's action arbitrary."[74]

In fact, the Communications Act *compels* prompt elimination of these ongoing Bell market power abuses. The Act requires that "*[a]ll* charges . . . and regulations for and in connection with . . . communications service . . . shall be just and reasonable."[75] Any charge or regulation that is "unjust or unreasonable is . . . unlawful."[76] And because the Commission has a "duty to execute and enforce the provisions of the Communications Act," the Commission must ensure that Bell rates for access services are "just, fair, reasonable and nondiscriminatory."[77]

As demonstrated above, the Bells' special access rates are patently unjust and unreasonable. The Bells' rates of return have been consistently rising for the last several years to increasingly unlawful levels, and since being granted pricing flexibility, the Bells have exacerbated the problem by imposing further rate increases. Where a carrier's

> returns have greatly exceeded a fair percentage of return upon a fair base, it follows as a matter of law that the rates charged . . ., instead of being "just and reasonable" as the law requires them to be, have been excessive. There is nothing new about this principle. Speaking for a unanimous Supreme Court, Chief Justice Taft said in 1924: "If the profit is fair, the sum of the rates is so. If the profit is excessive, the sum of the rates is so."[78]

And that is why the courts have made clear that permitting regulated entities to earn such excessive returns is the paradigm of arbitrary agency action and flatly violates an agency's

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[74] *Bell Atl. Tel. Cos.* v. *FCC,* 79 F.3d 1195, 1202 (D.C. Cir. 1996).

[75] 47 U.S.C. § 201(b) (emphasis added).

[76] *Id.*

[77] *See, e.g., American Tel. & Tel. Co.* v. *FCC.,* 572 F.2d 17 (2nd Cir. 1978).

[78] *Potomac Elec. Power Co.* v. *Public Utils. Comm'n of the District of Columbia,* 158 F.2d 521, 523 (D.C. Cir. 1947) (quoting *Dayton-Goose Creek R. Co. v. United States*, 263 U.S. 456, 483 (1924)).

statutory obligation to establish just and reasonable rates.[79] Thus, where, as here, regulated carriers have been able to exercise market power and earn supracompetitive profits in increasing amounts year over year, the Commission must aggressively use its broad regulatory powers to ensure that such carriers charge just and reasonable rates.[80] Indeed, the D.C. Circuit has previously held that it could not "countenance" excessive rates which "ensure 'creamy returns' to the carriers and are 'far more generous than those [rates] that the Commission and other regulators give elsewhere.'" *Farmers Union II*, 734 F.2d at 1503 (citations omitted).

That is especially true here, because the Commission's deregulation of special access rates was based on a predictive judgment that market forces would effectively constrain the Bells' prices.[81] That predictive judgment has not panned out – the Bells' own reported data show that competition has *not* protected special access customers from abuses of market power. It is therefore incumbent on the Commission to reassess its deficient special access regulations to account for these facts.[82]

The courts have made clear that where the Commission regulates rates on the basis of predictive judgments, it is imperative that "the Commission . . . vigilantly monitor the

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[79] *Illinois Bell Tel. Co.* v. *FCC*, 988 F.2d 1254, 1260 (D.C. Cir. 1993); *Farmers Union II*, 734 F.2d at 1497, 1502-03.

[80] *See Farmers Union II*, 734 F.2d at 1497, 1502-03; *see also FPC* v. *Texaco Inc.*, 417 U.S. 380, 399 (1974) ("[i]n subjecting producers to regulation because of anticompetitive conditions in the industry, Congress could not have assumed that 'just and reasonable' rates could conclusively be determined by reference to market price").

[81] *See WorldCom* v. *FCC*, 238 F.3d 449, 459 (D.C. Cir. 2001) ("The FCC readily admits that its decision to adopt the thresholds contained in the *Pricing Flexibility Order* was dependent, at least in part, on the agency's predictive forecasts"); *see also id.* at 462 ("The FCC made a predictive judgment that the amount of collocation required for each trigger will be sufficient to constrain anticompetitive practices by incumbent LECs").

[82] Notably, the Commission itself recognized in the *Pricing Flexibility Order* that the Bells might abuse their flexibility to charge rates that were not just and reasonable, and that the Commission might have to take remedial action. *See, e.g., Pricing Flexibility Order* ¶ 83.

consequences of its rate regulation rules."[83] And "[i]f, in light of actual market developments, the Commission determines that competition is not having the anticipated effect on access charges," the agency must "revisit the issue." *Texas Office of Public Utility Counsel* v. *FCC*, 265 F.3d 313, 325 (5th Cir. 2001); *see also SWBT* v. *FCC*, 153 F.3d 523, 547 (8th Cir. 1998) (same); *see also CELLNET* v. *FCC,* 149 F.3d 429, 442 (6th Cir. 1998) ("If the FCC's predictions about the level of competition do not materialize, then it will of course need to reconsider its [regulations] . . . in accordance with its continuing obligation to practice reasoned decisionmaking"); *Bechtel* v. *FCC*, 957 F.2d 873, 881 (D.C. Cir. 1992) (it is now "settled law that an agency may be forced to reexamine its approach if a significant factual predicate of a prior decision . . . has been removed."); *AFL-CIO* v. *Brock*, 835 F.2d 912, 916-17 (D.C. Cir. 1987) ("courts recognize that agencies must respond to changed circumstances to carry out Congress' purposes"). Put simply, because the Commission's predictive judgments concerning the ability of market forces to reign in the Bells' market power over access services have not materialized, it would be unlawful for the Commission to decline to modify its regulatory scheme in order to check the Bells' market power abuses.

The Commission has previously found it necessary to modify price cap regulation to ensure that access rates remained at "just and reasonable" levels. In 1995, the Commission found that "the price cap LECs had experienced higher earnings on average under price caps than in earlier periods" and found that these consistently high returns confirmed that the Commission's price cap system was not adequately keeping up with the LECs' cost improvements and adequately constraining the Bells' prices.[84] And again, in the *CALLS Order*,

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[83] *American Civil Liberties Union* v. *FCC,* 823 F.2d 1554, 1565 (D.C. Cir. 1987) (emphasis added).

[84] *See Price Cap Performance Review for Local Exchange Carriers*, 10 FCC Rcd 8961, ¶ 100

recognizing that the then-current "traffic-sensitive rate structure provide[d] price cap LECs with more revenue when demand increases, regardless of whether costs have increased, resulting in higher earnings," the Commission "target[ed] reductions to [those] traffic-sensitive services."[85] Consistent with these prior actions, and with its affirmative duty to address unjust and unreasonable rates and failed predictive judgments, the Commission can and must take immediate action to address the Bells' current exercise of market power over special access services.[86]

The Commission cannot reasonably rely on the Section 208 complaint process to address the Bells' unlawful special access rates.[87] Neither the injured carriers nor the Commission has the resources to resolve such a nationwide problem in the context of hundreds of individual rate

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(1995), *aff'd, Bell Atlantic Tel. Cos.* v. *FCC*, 79 F.3d 1195, 1202 (D.C. Cir. 1996) (upholding the order based in part on the fact that "[t]he Commission originally predicted that sharing would be rare, . . . [but i]n practice, sharing had become routine. By 1993, all seven of the Bell Operating Companies were in the sharing zone, leading the Commission to believe that the original X-Factor had been too low").

[85] *See CALLS Order* ¶ 171 & n.376.

[86] The *CALLS Order* is no bar to re-establishing effective regulation of the Bells' interstate special access services. Indeed, the Commission expressly stated in the *CALLS Order* that "the Commission has authority to modify the rules we adopt today before the end of the five-year term of the CALLS Proposal," and that the "Order addresses a marketplace that is dynamic and evolving, and the Commission may exercise its authority should the need arise." *CALLS Order* ¶ 36 n.45.

Similarly, the CALLS Agreement does not bar the requested relief. Section 4.2 of that Agreement states simply that the mechanisms laid out in paragraphs 2 and 3 of the CALLS Agreement constitute a fair and reasonable means of moving "usage sensitive rates" to the point achieved by those mechanisms. That section applies only to usage sensitive *switched* access rates. *See* Memorandum of CALLS in Support of Plan, p. 37 (August 20, 1999) (mechanisms in CALLS effect a freeze in the caps for the "services comprising switched access services"). In other words, Section 4.2 says simply that the means set forth in the Agreement for achieving the agreed-upon rates for switched access services (*i.e.*, what the *CALLS Order* terms the "average traffic-sensitive rate," or "ATS" rate) are a fair and reasonable means for achieving those rate levels. Section 4.2 does not apply to special access rates, which are not included in the ATS rates.

[87] *See* 47 U.S.C. § 208.

cases. Indeed, taken to its illogical extreme, this argument would permit the Commission to abandon the field altogether so long as it held open the prospect of allowing individual complaint cases. It is precisely for these reasons that the courts of appeals have held that the existence of a "safety valve" that permits a variance from a generally applicable regulatory scheme does not excuse an agency from failing to address a systemic problem inherent in the underlying regulatory scheme. For example, in *Time Warner Entertainment Co., L.P.* v. *FCC,* 56 F.3d 151 (D.C. Cir. 1995), the court of appeals considered a challenge to a provision of the Commission's rate-cap regime for cable television. The Commission failed to permit recovery of cost increases incurred in the period between the date on which the baseline rates were set and the effective date of the regulations.[88] The Court rejected the Commission's attempt to justify its decision on the grounds that disadvantaged cable companies could always seek the imposition of cost-of-service ratemaking. Because that option "is costly . . . and is intended to be a limited 'safety-valve' exception," the court held that it cannot be a widely-used mechanism for correcting an imprudent rate scheme.[89] Accordingly, the Commission cannot rely on the complaint process to remedy the endemic and unlawfully excessive special access rates spawned by the Bells' anticompetitive behavior and the Commission's overly-permissive regulatory scheme.

The bottom line is this: The Commission adopted its aggressive deregulation of the Bells' special access services based on a predictive judgment that competition would provide sufficient safeguards to protect against the Bells' exercise of monopoly power over special access customers. Years of data now confirm that the Commission's predictive judgment was wrong. Competition has not developed for special access services, and the Bells have

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[88] *See Time Warner*, 56 F.3d at 173.

[89] *Id.*; *see also Ass'n of Oil Pipelines* v. *FERC*, 281 F.3d 239, 244 (D.C. Cir. 2002); *American Gas Ass'n* v. *FERC*, 912 F.2d 1496, 1517-18 (D.C. Cir. 1990); *ALLTEL Corp.* v. *FCC*, 838 F.2d

consistently exercised market power to extract massive windfalls from IXCs, CLECs and end-user customers. This evidence conclusively establishes that current Bell special access rates are not just and reasonable and, therefore, are unlawful.

Because the Commission has an affirmative duty to enforce the act by ensuring that special access rates are just and reasonable, the Commission can and must take immediate action to establish meaningful regulatory constraints on the Bells' rates for all of their special access services. At a minimum, the Commission should revoke pricing flexibility and reinitialize price caps to levels designed to produce normal, rather than monopoly, returns. Moreover, given that existing special access rates are so far out of line with lawful, compensatory levels, the Commission should also adopt immediate, interim relief while the rulemaking is pending. In particular, the Commission should: (1) immediately reduce all special access charges for services subject to Phase II pricing flexibility to the rates that would produce an 11.25% rate of return,[90] and (2) impose a moratorium on consideration of further pricing flexibility applications pending completion of the rulemaking.[91] Retargeting special access rates to an 11.25% return on an interim basis is necessary to align prices more closely with what would be expected in a competitive market (and, indeed, with what was expected when the Commission granted pricing flexibility). Moreover, an 11.25% rate of return is the last authorized rate of return for the Bells

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551, 561 (D.C. Cir. 1988).

[90] The Commission could accomplish this easily by calculating the percentage reductions necessary to reduce each Bell's overall special access returns to 11.25%, and then applying that percentage reduction only to the rates that have been removed from price caps.

[91] The Commission has ample authority to institute interim rate relief pending the completion of a rulemaking, *see, e.g., Lincoln Tel. & Tel. Co.* v. *FCC*, 659 F.2d 1092, 1107-08 (D.C. Cir. 1981), and also to impose a moratorium on any further pricing flexibility petitions while a rulemaking is pending, *see Neighborhood TV Co., Inc.* v. *FCC*, 742 F.2d 629, 634-40 (D.C. Cir. 1984); *Kessler* v. *FCC*, 326 F.2d 673, 679-85 (D.C. Cir. 1963); *Western Coal Traffic League* v. *Surface Transportation Board*, 216 F.3d 1168, 1177 (D.C. Cir. 2000).

and is thus appropriate for retargeting rates on an interim basis (even though an 11.25% rate of return is quite generous given conditions in today's capital markets). In conjunction with this interim relief, the Commission should make clear that (3) this rate relief shall not trigger any termination liabilities or other penalty provisions of the Bells' OPP plans.[92]

[92] *See Local Exchange Carriers' Individual Case Basis DS3 Service Offerings*, CC Docket No. 88-136, 4 FCC Rcd. 8634, ¶ 79 (1989) (in ordering LECs to convert all individual case basis pricing for DS3 services to generally available rates, the Commission found that "we will not permit LECs to assess converted ICB customers termination liability charges or non-recurring charges").

CONCLUSION

For the foregoing reasons, the Commission (1) must reform and tighten rate regulation of the price cap ILECs' special access services, and (2) on an interim basis, should immediately reduce all special access charges for services subject to Phase II pricing flexibility to the rates that would produce an 11.25% rate of return and impose a moratorium on consideration of further pricing flexibility applications pending completion of the rulemaking.

Respectfully submitted,

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October 15, 2002

TAB A

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington D.C. 20554

In the Matter of AT&T Corp. Petition for Rulemaking To Reform Regulation Of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services	)	WC Docket No. 02-____

DECLARATION OF STEPHEN FRIEDLANDER

1. My name is Stephen Friedlander. I am a manager in the Law and Government Affairs Department at AT&T. My responsibilities include analysis of LEC financial data and tariff filings in support of AT&T's position on interstate access matters. I obtained a B.A. degree from Boston University in 1971 and a Ph.D. in economics from the University of Colorado in 1977.

2. I have calculated the Regional Bell Operating Companies' ("RBOC") rates of return for interstate special access services. These calculations are based on data the RBOCs filed in their ARMIS 43-01 reports. The ARMIS 43-01 report contains basic financial data - revenues, expenses, reserves, and investments - from which local exchange companies ("LECs") calculate their net returns and rates-of-return.

3. The data in the ARMIS 43-01 reports are provided on a state-by-state basis. That data includes the LECs' "net return" for special access (line 1915, column s), and the LECs'

"average net investment" for special access (line 1910, column s). Rates-of-return are computed by dividing the reported "net returns" by the reported "average net investments."

4. Because the data are reported on a state-by-state basis, my calculations aggregate the state data to obtain net return and average net investment at the company level. This calculation is very simple. All that is required is to sum the return and investment figures for special access in each state to obtain company-wide totals, and then calculate the percentage of total return to total investment for each company.

5. The results of these calculations are summarized in Exhibit 1 (attached). As illustrated by Exhibit 1, every RBOC has enjoyed substantially increasing rates-of-return every year since 1996, and last year these returns exceeded 37 percent for most of the RBOCs.

6. I have also provided a separate table (Exhibit 2) setting forth the RBOCs' annual revenues from special access since 1996. Once again, every RBOC has enjoyed substantial growth in special access revenues every year since 1996, and total RBOC/GTE special access revenues have more than tripled since 1996, from $3.4 billion to $12.0 billion.

7. As these results indicate, SBC's special access revenues in 2001 exceeded amounts that would have produced an 11.25% rate of return by $2.5 billion, allowing for a 40% marginal income tax rate. For the same year, Verizon, BellSouth, and Qwest earned amounts that exceeded an 11.25% return by more than $1 billion, $966 million, and $710 million, respectively.

RBOC SPECIAL ACCESS EARNINGS (IN THOUSANDS)

		Average Net Investment*	Net Return**	Rate of Return
BellSouth				
	1996	679,773	109,946	16.17%
	1997	763,053	133,008	17.43%
	1998	767,838	240,243	31.29%
	1999	898,339	290,944	32.39%
	2000	1,247,668	457,590	36.68%
	2001	1,525,302	751,379	49.26%
Qwest				
	1996	862,193	46,133	5.35%
	1997	856,845	116,455	13.59%
	1998	815,296	222,105	27.24%
	1999	944,811	304,047	32.18%
	2000	1,181,070	453,235	38.37%
	2001	1,206,625	562,002	46.58%
SBC				
	1996	1,753,989	221,594	12.63%
	1997	1,904,567	304,980	16.01%
	1998	2,147,399	526,036	24.50%
	1999	2,213,592	875,456	39.55%
	2000	2,907,473	1,257,433	43.25%
	2001	3,531,727	1,928,324	54.60%
Verizon* **				
	1996	2,385,403	51,012	2.14%
	1997	2,831,074	59,532	2.10%
	1998	3,402,154	290,073	8.53%
	1999	4,365,775	437,343	10.02%
	2000	5,101,276	797,119	15.63%
	2001	5,768,191	1,252,839	21.72%
Verizon (w/o NYNEX)				
	1996	1,714,759	47,364	2.76%
	1997	1,747,972	181,474	10.38%
	1998	2,228,025	302,309	13.57%
	1999	2,496,655	571,908	22.91%
	2000	2,801,863	836,684	29.86%
	2001	3,135,740	1,162,658	37.08%

* 1996-2001 ARMIS 43-01, Table I. Cost and Revenue Table, Special Access, Column (s), Average Net Investment, Row 1910.

** 1996-2001 ARMIS 43-01, Table I. Cost and Revenue Table, Special Access, Column (s), Net Return, Row 1915.

*** Verizon includes Verizon-North, Verizon-South and GTE.

RBOC SPECIAL ACCESS REVENUES (IN THOUSANDS)*

	BellSouth	Qwest	SBC	Verizon
1996	$508,929	$429,790	$1,217,546	$1,281,907
1997	$599,609	$566,877	$1,494,486	$1,639,877
1998	$762,893	$715,333	$1,954,938	$2,093,947
1999	$919,988	$921,313	$2,480,544	$2,810,671
2000	$1,233,258	$1,226,016	$3,405,544	$3,724,881
2001	$1,831,143	$1,528,226	$4,294,276	$4,353,031

* Source: ARMIS 43-01, Row 1090, Column (s).

I, Stephen Friedlander, declare under penalty of perjury that the foregoing is true and correct.

Stephen Friedlander

Executed on September 25, 2002.

TAB B

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	
AT&T Corp.	
Petition for Rulemaking To Reform Regulation of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services	WC Docket No. 02-_____

DECLARATION OF JANUSZ A. ORDOVER
AND ROBERT D. WILLIG
ON BEHALF OF AT&T CORP.

I. QUALIFICATIONS

A. Professor Ordover

1. My name is Janusz A. Ordover. I am Professor of Economics at New York University, which I joined in 1973. At New York University, I teach undergraduate and doctoral level courses in industrial organization economics, the field of economics that is concerned with competition among business firms and upon which "antitrust economics" is founded. I have devoted most of my professional life to the study and teaching of industrial organization economics and to its application through antitrust law and policy.

2. In July 1991, I was appointed by President George Bush to the position of the Deputy Assistant Attorney General for Economics in the Antitrust Division of the United States Department of Justice ("DOJ"). In this post, I participated in the drafting of the 1992 Horizontal Merger Guidelines, which have been widely used by courts and antitrust enforcement agencies. I returned to New York University in 1993.

3. I have written extensively on a wide range of antitrust and telecommunications topics, such as mergers and joint ventures, predatory conduct and entry barriers. My antitrust articles have appeared in the *Yale Law Journal*, the *Harvard Law Review*, the *Columbia Law Review*, and many other journals, monographs and books, here and abroad.

4. I have lectured extensively on antitrust topics to the American Bar Association, the International Bar Association, and the Federal Trade Commission ("FTC"). I have participated in numerous hearings on the future of antitrust at the FTC. I have also lectured on antitrust policy at colleges and universities in the United States and abroad, and at many conferences and meetings sponsored by various legal organizations.

5. I have acted as a consultant on antitrust and other competition matters to the DOJ, the FTC, and the post-communist governments of Poland, Russia, and Hungary. I have also consulted for the World Bank and the Organization for Economic Cooperation and Development in Paris. I have acted as a consultant in numerous antitrust litigation and investigations, including market definition and anti-competitive conduct matters for the FTC, Department of Justice and private clients in the United States, Australia, Germany and the European Union.

6. I have been involved in telecommunications issues in a variety of forums, such as the FCC, the OECD, and as a consultant to AT&T, Telstra, TelstraClear, and the governments of Argentina and various Eastern European countries.

B. Professor Willig

7. My name is Robert D. Willig. I am Professor of Economics and Public Affairs at the Woodrow Wilson School and the Economics Department of Princeton University, a

position that I have held since 1978. Before that, I was Supervisor in the Economics Research Department of Bell Laboratories. My teaching and research have specialized in the fields of industrial organization, government-business relations and welfare theory.

8. I served as Deputy Assistant Attorney General of Economics in the Antitrust Division of the United States Department of Justice from 1989 to 1991. I also served on the Defense Science Board task force on the antitrust aspects of defense industry consolidation and on the Governor of New Jersey's task force on the market pricing of electricity.

9. I am the author of *Welfare Analysis of Policies Affecting Prices and Products*; *Contestable Markets and the Theory of Industry Structure* (with W. Baumol and J. Panzar); and numerous articles, including "Merger Analysis, IO theory, and Merger Guidelines." I am also a co-editor of *The Handbook of Industrial Organization*, and have served on the editorial boards of the *American Economic Review*, the *Journal of Industrial Economics* and the MIT Press Series on regulation. I am an elected Fellow of the Econometric Society and an associate of The Center for International Studies.

10. I have been active in both theoretical and applied analysis of telecommunications issues. Since leaving Bell Laboratories, I have been a consultant to AT&T, Telstra and New Zealand Telecom, and have testified before the U.S. Congress, the Federal Communications Commission, and the public utility commissions of about a dozen states. I have been on government and privately supported missions involving telecommunications throughout South America, Canada, Europe, and Asia. I have written and testified on such subjects within telecommunications as the scope of competition, end-user service pricing and costing, unbundled access arrangements and pricing, the design of regulation and methodologies for assessing what activities should

be subject to regulation, directory services, bypass arrangements, and network externalities and universal service. On other issues, I have worked as a consultant with the Federal Trade Commission, the Organization for Economic Cooperation and Development, the Inter-American Development Bank, the World Bank and various private clients.

II. PURPOSE AND SUMMARY OF TESTIMONY

11. In this declaration, we discuss the appropriate regulatory treatment of special access services provided by the regional Bell operating companies ("RBOCs"). As we have explained in previous filings, the Commission should refrain from regulating where markets are workably competitive. Where markets are functioning well, there is no justification for undertaking the daunting task of substituting regulation for market processes to establish optimal prices, quantities, technologies and business models.

12. We have also made clear, however, that when a local exchange carrier controls an essential facility in a relevant market, and has incentive to abuse its market power, regulation is not only appropriate but necessary. Competitive forces cannot constrain the pricing and quality decisions of firms with such market power, and they inevitably will charge supracompetitive rates and attempt to withhold critical inputs that would allow others to challenge their supremacy. The result is a misallocation of resources caused by supracompetitive prices, and possibly wasteful spending by the monopolist to preserve its dominance.

13. We have also made clear in the past that there is no one-size-fits-all regulatory scheme. Regulatory commissions should be free to develop new ways of replicating market forces that are less costly and cumbersome. In this regard, we applaud the Commission's

attempts to engage in precisely this type of experimentation in connection with regulation of special access services.

14. In the 1990s, the Commission shifted from traditional rate of return regulation of the RBOCs' (and other large incumbents') special access charges to a price cap method. The price cap regime originally contained numerous protections for consumers, such as the "sharing" mechanism (which required price cap reductions if the RBOCs' rates of return exceeded a certain threshold) and the X-Factor (which required annual reductions for anticipated gains in productivity). Significantly, the rate of return threshold under the Commission's previous rules was never higher than 17.25%: that level triggered 100% sharing by the RBOCs.

15. Ultimately, the Commission recognized that, to the extent possible, the best way to regulate RBOC special access rates was to subject them to competition from other facilities-based providers. Thus, even prior to the adoption of the Telecommunications Act of 1996, the Commission issued a series of orders designed to promote exchange access competition and eliminate the *de facto* monopoly franchises that the RBOCs had enjoyed up to that time.

16. As we explain in greater detail below, the economic structure of this market has hampered the emergence of special access competition. Nevertheless, some competitors were able to enter on a facilities basis in some dense urban areas and provide alternative access services for the largest business customers. Seizing upon this nascent "competition," the RBOCs petitioned the Commission for forbearance from existing dominant carrier regulations. In several proceedings involving forbearance requests by individual RBOCs, we filed testimony cautioning against the sweeping relief from

regulation that the RBOCs were seeking.[1] Our testimony showed that the deregulatory relief sought by the RBOCs was far broader than the scope of competition that they faced and, therefore, would deregulate RBOC special access rates even in relevant markets where the RBOCs faced little, or no, effective competition.

17. The Commission's 1999 *Pricing Flexibility Order*,[2] however, undertook a radical change from its prior regulatory schemes: the Commission established "triggers" that permit incumbent carriers to remove special access services from price cap regulation altogether. While acknowledging that the incumbent carriers continued to be dominant, the Commission decided that the incumbents could not exercise market power wherever they faced competition from competitive local exchange carriers ("CLECs") with sunk facilities. The Commission also adopted the triggers that, it predicted, would accurately measure the existence of irreversible competition in the geographically appropriate markets.[3]

18. The purpose of our testimony is to evaluate these predictions in light of the last three years of experience. We conclude that the conduct and performance of the RBOCs since 1999 provide unambiguous evidence that the RBOCs, far from facing effective

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[1] *See* Declaration of Janusz Ordover and Robert Willig on behalf of AT&T in CC Docket No. 99-65, *Petition of Ameritech for Forbearance from Dominant Carrier Regulation of its Provision of High Capacity Services in the Chicago LATA* (March 31, 1999); Declaration of Janusz Ordover and Robert Willig on behalf of AT&T in CC Docket No. 99-24, *Petition of Bell Atlantic Telephone Companies for Forbearance from Regulation as Dominant Carriers in Delaware; Maryland; Massachusetts; New Hampshire; New Jersey; New York; Pennsylvania; Rhode Island; Washington, D.C.; Vermont; and Virginia* (March 18, 2001).

[2] *Pricing Flexibility Order*, 14 FCC Rcd. 14221 (1999).

[3] *See id.* ¶¶ 3, 69-70.

competition for their special access services, enjoy monopoly power that is virtually unchecked. *See infra* Part III. The RBOCs' special access services generate returns on investment as high as *56 percent per year*—even using the RBOCs' embedded investment dollars in ARMIS as a measure of the RBOCs' net investment—and much higher rates of return on the forward-looking economic value of the RBOCs' investment. The RBOCs have been able to sustain large increases over their already excessive rates in recent years, and have failed to make even a gesture of reducing rates where the Commission has authorized downward pricing flexibility. Furthermore, we understand that the quality of service provided in return for these prices has been poor.

19. We also explain why, despite the RBOCs' high prices, supracompetitive returns, and poor service, virtually no significant entry by competitors has occurred. *See infra* Part IV. This absence of competitive reaction and market restraint is precisely what an economist should predict from the daunting and enduring barriers to competitive entry that protect the incumbents. Transmission facilities are characterized by large economies of scale and by sunk costs. Further, there are powerful barriers to entry by second-mover CLECs that would compete with incumbents that already possess facilities capable of serving all existing demand.

20. Finally, we explain that the harms of allowing the RBOCs to exercise unchecked market power go beyond high rates, but also will allow the RBOCs to impede competition from competitive providers of access and other local services, purchasers of access services, and consumers of telecommunications services. *See infra* Part V. Facilities-based entry can be thwarted by these tactics because competitors need access to incumbent loop-transport facilities both to deploy local switches and as a "bridge" for self-deploying

facilities. The Commission's rules have prevented CLECs from obtaining these facilities as cost-based UNEs and instead have forced CLECs to use the supra-competitively priced special access as a substitute. Pricing flexibility has also given the RBOCs the ability to heighten the perceived entry risks facing the CLECs by responding with deep price reductions whenever a competitor actually achieves facilities-based entry or by locking up customers needed by a potential entrant to support competitive entry. These strategies appear to have deterred entry that would have reduced prices and improved consumer welfare. Finally, the RBOCs' monopoly power over special access can harm competition in long distance services (and any "bundled" offering that contains long distance components), as the RBOCs increasingly have an incentive to use special access pricing to effect anticompetitive price squeezes against unaffiliated long distance carriers.

III. THE CONDUCT AND PERFORMANCE OF THE RBOCS SINCE 1999 HAS REFUTED THE COMMISSION'S PREDICTION THAT MARKET FORCES WOULD CONSTRAIN THE RBOCS' SPECIAL ACCESS PRICING.

21. As noted above, the Commission's 1999 *Pricing Flexibility Order* established "triggers" that, when satisfied, allow nearly complete deregulation of the incumbents' special access offerings. As we and AT&T showed previously, these triggers were misconceived. First, the Commission granted the MSA-wide deregulation of rates based on a showing that only a relatively small percentage of the relevant routes in the MSA had facilities-based competitive alternatives. Thus, these triggers permitted deregulation of a large geographic area—an entire MSA—even if collocation arrangements were limited to a few offices. Second, the triggers for the transport elements of special access were overbroad, because they authorized the deregulation of all of the transport rate elements even though the Commission's "fiber-based collocation" test generally indicated the

presence of competitive facilities along only one piece-part of transport – entrance facilities. Third, the channel termination trigger was even more flawed, because it permitted deregulation of channel termination rates based solely on the deployment of *transport* – a deployment that in no way implies that competitors have deployed their own loops.

22. Experience has now exposed the flaws in the Commission's prediction that the triggers actually measured the existence of sunk, competitive alternatives that constrain special access market power. Since receiving pricing flexibility for services producing a majority of their special access revenues, the RBOCs have earned increasing supra-competitive profits – whether measured on the basis of historical or economic costs. The quality levels of these services have declined over this same period. And despite charging higher prices for lower quality, the RBOCs' special access revenues and usage have continued to grow. The reason for this is simple. The RBOCs' special access customers have no effective alternatives.

A. The RBOCs Have Earned Large And Growing Supra-Competitive Profits From Their Special Access Rates.

23. In effectively competitive markets, returns significantly exceeding a competitive cost of capital are unsustainable because market forces limit prices over the long run to forward-looking, economic costs. Economic costs, of course, include the cost of obtaining debt and equity capital. But in competitive markets, debt and equity investors earn – and a company can pay – no more than the "normal" profits needed to compensate investors for the risk of the investment. Any attempt by a firm in an effectively competitive market to charge prices that would generate more than a normal, risk-adjusted rate-of-return would

cause the firm to lose business to other firms that limited their prices to the lower levels needed to attract and retain investment capital. It is precisely for these reasons that the very definition of supra-competitive profit is return in excess of risk-adjusted normal profits.

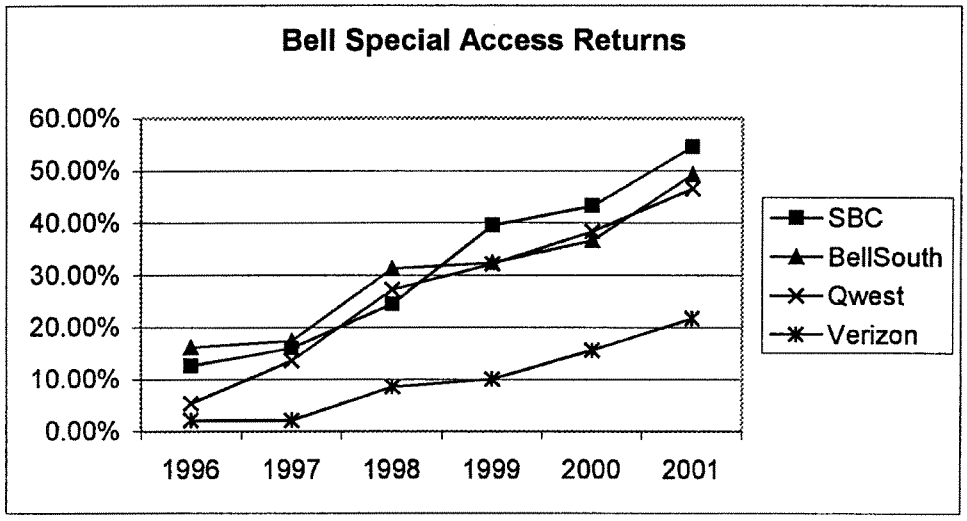
24. The returns being earned by the RBOCs on special access services are well in excess of those that would be earned by providers of special access facing effective market competition. The RBOCs' own ARMIS reports to the Commission establish that their rates of return on special access are multiples of the 11.25% rate of return that the Commission has previously found just and reasonable for dominant incumbent services. For 2001, the RBOCs' special access rates of return were as follows:[4]

BellSouth	49.26%
Qwest	46.58%
SBC	54.60%
Verizon	21.72%
Verizon (without NYNEX)	37.08%

25. These supra-competitive rates of return are the fruit of overcharges in dollar terms. For 2001 alone, the RBOCs' excessive special access prices generated approximately $5 billion of excessive earnings for the RBOCs from consumers and other downstream

[4] The figures and charts pertaining to the RBOCs' rates of return cited in this section are based on the work performed by Mr. Friedlander in his accompanying declaration.

customers.[5] The trend in the Bells' excess returns from special access is even more striking. As the following chart demonstrates, the RBOCs' interstate special access rates of return continue to grow every year, with no exceptions. Furthermore, the year-to-year increases are quite dramatic; each RBOC's rate of return is now at least five times higher, and in some cases *10 times higher*, than in 1996.



26. Even higher are the RBOCs' returns on the forward-looking economic value of their investment—the economically relevant measure of the return on investment. The costs reported on the RBOCs' ARMIS reports are, of course, embedded costs. And, as the Commission and the courts have consistently recognized, the RBOCs' true costs of providing services over their local networks are their much lower forward-looking

[5] Assuming an income tax rate of 40 percent, approximately $3 billion of these excess earnings are retained by the RBOCs as monopoly rents.

economic costs.[6] The RBOCs' special access rates exceed their economic costs by an enormous margin.

27. One way to estimate the magnitude of this margin is to compare the RBOCs' rates for special access services with the same carriers' rates for the most comparable loop and transport elements. Special access services are provided over the same facilities and are functionally equivalent to high capacity loop and transport unbundled network elements. Yet, the RBOCs' special access rates are generally at least double their comparable UNE rates. The Stith Declaration compares, on a state-by-state basis, the RBOCs' tariffed interstate special access rates with the rates for the comparable unbundled network elements in that state. For services still subject to price cap regulation, the RBOCs' month-to-month DS1 and DS3 special access rates are often more than 100% higher than the comparable UNE rates, and sometimes they are even 200% or 400% higher. Thus, if the RBOCs' annual special access returns are calculated on the basis of their *economic* costs, as indicated by UNE rates, rather than their embedded costs, it becomes clear that their real returns on these services are enormous – typically in excess of 100 percent annually. This is powerful evidence that the RBOCs have market power in the provision of special access services to end users and other carriers.

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[6] *See, e.g.*, *Local Competition Order*, 11 FCC Rcd. 15499, ¶ 679 (1996) ("We believe that our adoption of a forward-looking cost-based pricing methodology . . . establish[es] prices . . . based on costs similar to those incurred by the incumbents."); *Verizon Communications Inc. v. FCC*, 122 S. Ct. 1646, 1672 (2002) (costs that exceed TELRIC are inefficient costs); *Alenco Communications Co. v. FCC*, 201 F.3d 608, 615 (5th Cir. 2000) ("rates must be based not on *historical, booked costs*, but rather on *forward-looking, economic costs*. After all, market prices respond to current costs; historical investments, by contrast, are sunk and thus ignored.").

B. The RBOC Pricing Behavior Provides Further Evidence Of Their Market Power in Special Access.

28. The RBOCs' pricing behavior offers yet further evidence that the RBOCs exercise substantial market power. As AT&T explains in its Petition, in *every* MSA where the RBOCs have obtained "Phase II" pricing flexibility (*i.e.*, removal of special access from price caps), the RBOCs have maintained or even *raised* their tariffed month-to-month special access rates. Indeed, both BellSouth and Verizon have increased their tariffed month-to-month special access rates in every MSA in which they have been awarded Phase II pricing flexibility since 1999.[7]

29. The effect of removing rates for special access from RBOCs' price caps can be measured directly because the Commission requires price-cap incumbent carriers to continue to file their rates in tariffs even after receiving Phase II pricing flexibility. As AT&T explains in its Petition, the tariffed rate in Phase II MSAs no longer subject to price cap regulation is equal to or higher than the rate for the same service in areas that remain subject to price cap regulation for virtually every special access service in every state for every Bell.[8]

30. It is our understanding that the RBOCs' have defended their rate hikes by citing the Commission's statement in the *Pricing Flexibility Order* (¶ 155) that "some access rate increases may be warranted, because our rules may have required incumbent LECs to price access services below cost in certain areas." But such a claim is unsustainable from an economic perspective. As the charts above show, the RBOCs' rates of return were

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[7] Stith Decl., Exhibit 1.

[8] *Id.* The only exception is Ameritech's rates for OC-3; the pricing flexibility rate is one percent lower than the price cap rate.

already above any plausible measure of their cost of capital *before* the increases. Indeed, it is notable that after most special access has now been removed from price caps, the RBOCs have not seen fit to respond to any claimed instances of competition by lowering their generally available tariffed rates in *any* of those MSAs.

C. The Quality of Special Access Service Provided By The RBOCs Has Been Poor, But Revenues And Usage Have Continued To Increase.

31. Other evidence of the RBOCs' monopoly power over special access is the poor quality of their performance in provisioning special access services.[9] The Joint Competitive Industry Group, which represents a spectrum of purchasers of special access (including non-carrier end-user customers), has documented the poor quality of the incumbents' performance over the last few years.[10] The ability of the RBOCs to impose rates that earn ever increasing returns, while simultaneously lowering the quality of those services, is strong evidence that customers rarely have alternative sources of supply.

32. At the same time, interexchange carriers ("IXCs") and other competitive local carriers have been increasingly forced by the lack of regulatory or competitive alternatives to rely on the Bells' deregulated access services, even to provide competitive local services. As explained in the accompanying Declaration of Mr. Friedlander, each of the RBOCs has experienced double-digit annual growth in special access usage.[11] As a consequence of increasing prices and increasing volumes, overall RBOC special access revenues have

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[9] *See* Notice of Proposed Rulemaking, *Performance Measures and Standards for Interstate Special Access Services*, CC Docket No. 01-321 (Nov. 19, 2001); Comments of AT&T, CC Docket No. 01-321 (filed January 22, 2002).

[10] *See* Comments of AT&T, CC Docket No. 01-321 (filed January 22, 2002).

[11] *See* Friedlander Decl. ¶ 6 & Exhibit 2.

more than tripled since 1996, from $3.4 billion to $12.0 billion. All RBOCs have participated in this trend, which has accelerated in recent years.

33. Of course, if viable alternatives to the last mile of the RBOCs' facilities actually existed, the RBOCs would not be able to impose large rate increases, lower quality, and simultaneously increase overall usage of their networks. Nor have carriers been able to use UNEs to bypass the RBOCs' special access services. As we explain below, and as AT&T has explained in even greater detail in the Triennial UNE Review Proceeding, because of the Commission's use and commingling restrictions on enhanced extended links ("EELs"), IXCs and CLECs must rely on RBOC special access to provide both exchange access *and* local service.

IV. HIGH BARRIERS TO ENTRY HAVE ALLOWED FEW COMPETITIVE ALTERNATIVES TO THE RBOCS' SPECIAL ACCESS SERVICES DESPITE THEIR HIGH PRICE AND LOW QUALITY.

A. The Marketplace Evidence Confirms That There Are Few Alternatives To RBOC Special Access Services.

34. An equally significant indication of the RBOCs' ability to maintain their monopoly power over special access is the absence of significant new facilities-based entry in response to the high price and low quality of the RBOCs' services. Three years after the Commission began its experiment in deregulation, facilities-based competition for special access remains limited, costly, inefficient and unreliable.

35. AT&T has provided substantial evidence, both in the testimony accompanying this filing and in the Triennial Review Proceeding, that, despite billions of dollars in investments, AT&T and other CLECs have been able to replicate only a small fraction of the Bells'

high-capacity network.[12] Indeed, even when AT&T has self-deployed fiber transport rings, it remains generally dependent upon the ILECs both to provide local loops and to provide transport to aggregate traffic from low demand central offices to hubs where the fiber ring is deployed.[13] The result is that the lion's share of AT&T's access dollars go to the Bells.[14]

36. Moreover, AT&T's opportunities to expand its use of facilities-based alternatives are severely limited. As explained in the separate declaration of Ken Thomas, only a small fraction of the buildings where AT&T currently purchases special access have sufficient demand that it would be even theoretically feasible to consider the deployment of alternative facilities. And even then, AT&T, as well as other CLECs, are often unable to secure the necessary rights-of-way, or convince customers to switch away from ILEC-provided loops.

37. Nor, as Mr. Thomas explains, can AT&T turn to other CLECs, because they too have established alternative facilities to only a small fraction of buildings. AT&T has contractual arrangements with virtually all of the major CLECs that offer facilities-based access services, such as MFS/WorldCom, Adelphia, and Time Warner. These CLECs, however, can provide access to only a small number of additional buildings nationwide.[15]

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[12] *See* Comments of AT&T Corp., CC Docket No. 01-338, at 148-58 (filed Apr. 5, 2002) ("AT&T Triennial Review Comments"); Reply Comments of AT&T Corp., CC Docket No. 01-338, at 179-87, 257-67 (filed July 17, 2002) ("AT&T Triennial Review Reply Comments").

[13] *See* AT&T Triennial Review Comments at 149-50; AT&T Triennial Review Reply Comments at 294-96.

[14] *See* AT&T Triennial Review Reply Comments, Pfau Reply Dec. ¶ 26 n.10.

[15] *See* Thomas Dec. ¶¶ 6-7.

Further, even where AT&T has a contractual arrangement with a CLEC, AT&T often cannot use that CLEC to provide access.[16]

B. The Transmission Facilities Used To Provide Special Access Services Have Monopoly Characteristics And Are Protected By High Entry Barriers.

38. The record from the Triennial UNE Review Proceeding demonstrates that, because of basic economic and network engineering considerations, competitors will be able to deploy alternative facilities in only limited circumstances. Loop and transport facilities are characterized by substantial economies of scale and sunk costs. Thus, in most instances, replicating incumbent transmission facilities would be economically wasteful. And even in those few instances where self-deployment can be economically justified, barriers to entry -- such as the inability to obtain necessary rights-of-way in a timely fashion -- often prevent competitive deployment of facilities.

39. *Transmission Facilities Are Characterized By Substantial Economies Of Scale.* We understand that most of the cost of deploying loops, including "high capacity" loops, is in the supporting structures, placement, rights of way, and access to buildings, and not in the conductors (fiber strand or copper wires) themselves. The costs of the actual conductor – be it copper or fiber – represent only a small portion of the overall deployment cost.

[16] As Mr. Thomas explains (¶¶ 8-11), many CLECs have overstated the extent to which they have buildings "on-net," most of the major CLECs that provide alternative access have gone bankrupt, and capacity on wholesalers' networks is also often very expensive, because wholesalers typically price their services just under the price umbrella of the Bells' special access services.

Because the costs of supporting structures are relatively insensitive to the number of wires or fiber deployed, the Bells enjoy substantial economies of scale.[17]

40. Dedicated transport is also characterized by substantial economies of scale and scope.[18] Not only do the Bells have fiber interconnecting virtually all of their central offices (either directly or indirectly), they also generally deployed dark fiber capacity at the time of the initial facility construction, so they can dramatically increase lit capacity on most routes simply by adding or upgrading the terminating electronics at relatively small incremental costs (and certainly at a trivial cost compared to new construction). Thus, even on specific, high-demand point-to-point routes, a CLEC cannot hope to achieve the per-unit cost of the Bells' transport.

41. *Transmission Facilities Are Characterized By Substantial Sunk Costs.* The difficulties in self-deploying transmission facilities in competition with incumbents are compounded by the sunk character of the costs of building loop and transport facilities. An investment in an asset is sunk if, once made, it cannot be recovered by removing the asset from service. Invested capital funds spent on trenching, structure, and rights of way for a loop clearly fall into this category. It is basic economics that the need to incur significant sunk costs to deploy facilities that have substantial scale economies can result in significant entry barriers.

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[17] AT&T Triennial Review Reply Comments at 148-60.

[18] *Id.* at 148-52.

42. When substantial sunk investments must be made, an entrant may be reluctant to undertake an investment if there is a material risk that the costs of the investment will not be recovered. As one of us has previously explained:

> The reasoning for this is straightforward. If costs are sunk, the potential entrant knows that it will not be able to recover its costs if it is unable to attract sufficient revenues to recover the sunk costs. At the same time, because of economies of scale, the new entrant will incur higher per-unit costs, making it difficult for it to win sufficient customers away from the incumbent. Further, because the incumbent has already sunk its costs and has very low marginal costs, there is a significant threat that the incumbent could drop its prices in response to competitive inroads at any time down to its short run costs.[19]

43. There is broad agreement among economists that industries characterized by *both* declining average costs *and* sunk costs have the properties of natural monopolies protected by economic entry barriers.[20] Thus, in such an industry, even if an entrant could reasonably approximate the scale economies of the incumbent, the threat that the incumbent would respond with prices close to the short term variable costs, thereby making it impossible for the entrant to recover sunk costs, may deter all but targeted, limited entry. The Commission has recognized this point.[21]

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[19] AT&T Reply Triennial Reply Comments, Willig Reply Dec. ¶ 21.

[20] W. Baumol, J. Panzar, and R. Willig, CONTESTABLE MARKETS AND INDUSTRY STRUCTURE (1982); D. Carlton and J. Perloff, MODERN INDUSTRIAL ORGANIZATION (3rd ed. 2000).

[21] *See Section 257 Report*, 12 FCC Rcd. 16802, ¶ 18 n.48 (1997) ("If entry into an industry requires large sunk costs, the firm that incurs these sunk costs first (the incumbent) can have a tremendous advantage. Potential new entrants may realize that any large scale facilities-based entry into the market will probably force prices to decrease and those prices may be in fact below the point necessary to recover the sunk cost investment. As a result, facilities-based entry will be deterred."); *see also MCI-BT Merger Order*, 12 FCC Rcd. 15351, ¶ 162 (1997) (same).

44. *ILECs Have Enormous First-Mover Advantages.* Finally, the Bells enjoy first mover advantages over any CLEC that further compound the entry risks and create disincentives to entry. As first movers, the Bells received rights-of-way from local governments for underground cables, telephone poles and wires with only minimal transactions costs, because potential telecommunications customers in the neighborhood or municipality otherwise would not receive any telecommunications services. Similarly, building owners and landlords welcomed and accommodated Bells that were the only viable provider of telecommunications facilities to their properties. As subsequent entrants, CLECs, on the other hand, generally cannot rely on existing facilities, rights of way, or conduit.[22] Rather, a CLEC must construct the loops and transport from scratch, which takes many months of pre-construction while, at the same time, it tries to negotiate the necessary rights of way and construction permits from the municipality and negotiate the terms of building access from the landlord.[23] Rather than welcoming additional competition, these entities often view CLEC requests for rights-of-way as a nuisance. Retail customers understandably do not wish to wait the many months necessary for the competitive carrier to negotiate through this thicket.[24] Further, whereas the Bells entered the pertinent markets free of competitors and, as a result, have facilities in place to serve all customers, CLECs must often commit to deployments based on projections or speculation that there will be demand for such facilities thereby facing higher market risk and thus potentially higher cost of capital.

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[22] AT&T Triennial Review Reply Comments at 164-65, 171-77.

[23] *Id.*

[24] *Id.* at 171-73.

45. CLECs must also incur substantial marketing costs to attract customers now served by the RBOCs. Unlike the RBOCs, which started with no competition, CLECs must expend significant sums to market their services, develop a brand and convince consumers to switch from their incumbent provider.[25] Thus, CLECs need to spend much more per customer on marketing efforts to win customers away from the RBOCs, and generally also have to underprice the RBOCs to obtain business. "[E]ntrants must entice customers with a lower price and/or incur a greater selling expense per unit than the incumbent(s). . . . As a result, . . . an entrant must incur promotional expenditures to overcome the incumbent's existing market dominance. Such expenditures are unrecoverable by the entrant in the event of market exit and may constitute, therefore, a sunk cost impediment to entry."[26] For all of these reasons, there is no sustainable basis to conclude that new entry can be relied upon to constrain the RBOCs' special access rates any time soon.

V. THE RBOCS HAVE THE ABILITY AND INCENTIVE TO USE THEIR MARKET POWER TO HARM USERS OF SPECIAL ACCESS AND STIFLE COMPETITION IN ADJACENT MARKETS.

46. As discussed above, the RBOCs have used their Commission-authorized pricing flexibility over special access to collect billions of dollars in supracompetitive profits. These rents are an unnecessary transfer of resources to the RBOCs from their customers and, ultimately, from consumers. The deadweight economic loss that results from this overpricing and the resulting suppression of demand for special access services and the

[25] *UNE Remand Order*, 15 FCC Rcd. 3696 ¶ 87 (1999).

[26] *See First Video Competition Report*, 9 FCC Rcd. 7442, ¶¶ 39-40 (1994).

services they make possible, relative to the level of demand that would be forthcoming at competitive prices, is undoubtedly significant as well.

47. But this significant and unnecessary drain on the economy is only one of the manifestations of the RBOCs' special access dominance. Basic economics predicts that the RBOCs will have the incentive and ability to use their control over essential last mile facilities to impede competition in a number of adjacent product markets.

A. Strict Regulation Of Special Access Rates Is Necessary To Protect Facilities-Based Local Competition.

1. The RBOCs' Inflated Prices For Special Access Have Erected A Major Barrier To Entry By Potential Facilities-Based Competitors Into Retail Markets For Local Telephony.

48. High special access rates inhibit the entry of CLECs into local markets using their own facilities. Special access services are critical to local competition because the current regulatory regime does not allow CLECs to substitute combinations of loop and transport UNEs. As AT&T has explained, the Commission has permitted incumbents to impose "use" and "commingling" restrictions on combinations of unbundled loops and transport facilities that have largely prevented CLECs from converting special access services into unbundled network elements.[27] We understand that over 98% of AT&T's facilities-based *local* service for business customers using incumbent facilities of DS-1 level or higher is provided over incumbent special access services, not UNEs.[28]

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[27] Comments of AT&T Corp., CC Docket No. 96-98, at 18-23, (filed April 5, 2001) ("AT&T Use Restriction Comments"); AT&T Triennial Review Reply Comments at 283-300.

[28] *See* AT&T Triennial Review Reply Comments, Pfau Reply Dec. ¶ 26 n.10.

49. Without access to cost-based loop-transport UNE combinations known as EELs, CLECs depend on the availability of reasonably priced special access "services" to deploy CLECs' own switches and other local facilities. CLECs lack the geographically concentrated customer bases that the ILECs enjoy. Thus, to deploy switches with the same capacity (and, therefore, scale economies) as the ILECs, CLECs must be able to serve a more geographically dispersed customer base. Special access provides a necessary means to link potential customers to CLEC switches.

50. But, as explained above, special access rates are typically twice (and sometimes three or four times) the TELRIC rates for the comparable UNEs. And, critically, because TELRIC measures the incumbent's true economic costs, the fact that access rates are typically twice TELRIC means that the CLEC's cost of accessing the underlying facilities is usually twice (or more) that of the incumbent. Effective facilities-based competition is particularly difficult and unlikely under these conditions.

51. More subtly, CLECs need access to ILEC transmission facilities as a "bridge" mechanism to self-deploying their own transmission facilities in the few instances where it might be economic to do so. Because most of the investment in transmission facilities is likely to be sunk once made, competitive carriers are unlikely to be willing to build transmission facilities "on spec" and hope that customers will show up. Rather, potential entrants need some reasonable assurance that there is sufficient demand to support a deployment of transmission facilities. Customers, on the other hand, may be unwilling to commit to service and then wait the many months (or years) needed for the CLEC to obtain the necessary rights-of-way and build transmission facilities.

52. Further, the substantial economies of scale of transmission facilities render uneconomic the construction of a competitive carrier's own transmission facilities unless the carrier can aggregate traffic from numerous LSOs to a hub, and then place the aggregated traffic onto its own transport facilities at the hub.[29] Without access to EELs at TELRIC rates, CLECs face a dilemma. They can either pay excessive special access rates to reach those additional LSOs, thereby incurring excessive costs of purchased inputs from the RBOCs and burdening themselves with a cost structure that precludes them from competing effectively with the ILECs, or they can attempt to build fiber facilities with enormous excess capacity and substantial up-front costs that would dwarf the reasonably anticipated revenue stream. In either case, these costs – which the Bells do not face – impede effective entry into retail markets for local telephone services, and lessen the ability of competitive providers of telecommunications services to constrain the market power of the RBOCs.

2. The RBOCs' Ability To Engage In Targeted Pricing And Customer Foreclosure Also Acts as a Deterrent Against Facilities-Based Entry Into The Provisioning Of Special Access Services.

53. The existing rules not only enable ILECs to charge excessive prices for critical inputs that serve as a necessary bridge or complement to facilities deployment, thereby harming competition in the retail market for local telephony, but they also give RBOCs the ability to deploy discriminatory contract tariffs that can target any attempted competitive inroads into the intermediate market for special access. In particular, the existing pricing flexibility rules permit the RBOCs to price discriminate in a manner that may further

[29] *See* AT&T Triennial Review Comments at 136-38; AT&T Triennial Review Reply Comments at 251-52.

stymie entry or induce exit of efficient competitors and to use long term contracts to deny competitors access to the traffic necessary to justify facilities deployment.

54. *Targeted Pricing.* It has been noted that the RBOCs' excessive special access rates seemingly create a "price umbrella" over those CLECs that actually deploy alternative facilities. While this may be true for the few existing facilities-based CLECs, the presence of such an umbrella could offer little comfort to potential entrants. To the extent that an RBOC can price discriminate under the existing pricing rules, it will be able to lower prices selectively—*i.e.*, to only those customers that could potentially be served by the new entrant—while keeping prices high for all other customers. For example, if a competitive carrier were to deploy transport facilities between two points, an RBOC could respond by lowering prices on that route but not any others. Although such responses may, of course, occur in competitive environments, here it has the undesirable effect of prolonging market dominance by a firm that was able to make a large portion of its sunk investment in a regulated regime.

55. Thus, the RBOCs' option of cutting prices in response to facilities-based entry, coupled with the high degrees of scale economies, sunk costs, and second-mover disadvantages add up to a powerful deterrent to future competitive entry, unless the new entrant has substantial cost (*i.e.*, technology) or other advantages over the incumbent. Companies that would depend on the RBOC for critical inputs would, if anything, be even more unwilling to enter the market, because the likelihood of losses would be further elevated by the unreasonable prices that they would be required to pay to the RBOC for those inputs.

56. The Commission in its *Pricing Flexibility Order* was "concerned" about this: "Phase I relief, which enables [the Bells] to offer contract tariffs to individual customers, [could permit the Bells] to engage in exclusionary conduct."[30] The Commission observed that, absent regulation, the Bells had the ability to "reduce prices in the short run and forgo current profits in order to prevent the entry of rivals or to drive them from the market."[31] Because the Bell almost always enjoys substantial advantages over the CLEC in terms of per-unit costs, the Bell can reduce its rates to a point between its own unit cost and that of the CLEC at any time. As a result, the RBOC can deter or drive any CLEC from the market to the extent the CLEC's business plan is based on being able to charge prevailing supracompetitive access prices.[32]

57. The Commission believed that it could protect against these concerns by granting downward pricing flexibility only where CLECs had made "substantial sunk investment."[33] The Commission reasoned that where investment in alternative facilities had been sunk, the Bells would have no incentive to engage in exclusionary behavior because there would be little prospect of driving the CLECs out of the market. "If a competitive ILEC has made a substantial sunk investment in equipment, that equipment remains available and capable of providing service in competition with the incumbent, even if the incumbent succeeds in driving that competitor from the market."[34]

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[30] *Id.* ¶ 79.

[31] *Id.*

[32] *See* AT&T Triennial Review Reply Comments, Lesher Reply Dec. ¶ 28.

[33] *Pricing Flexibility Order* ¶ 80.

[34] *Id.*

58. The Commission's reasoning was too narrow. The sunk character of much of the investment in a competitive carrier's facilities does not eliminate the rationale for acting aggressively against an entrant when such aggressive behavior can reduce the likelihood of future additional entry in the same market or other markets. The economic literature cited by the Commission in its order pertaining to the incentives for "predatory" conduct focuses on situations where only entry in a single market by a single competitor is at stake. The incumbent's incentives, however, can change dramatically when multiple markets or entry by multiple carriers are involved. There is now a substantial economics literature demonstrating that an incumbent may want to use "predatory" actions (for example, price below some pertinent measure of cost) to establish a reputation for "toughness" and thereby dissuade subsequent potential entrants from invading its turf.[35] Thus, even though such conduct may be costly in the short run, it may nevertheless be a profitable business strategy if it lessens likelihood of entry over a long run.

59. The Bells' expert, Alfred Kahn, has agreed:

> The extent to which markets are effectively contestable cannot logically be independent of the ways in which the rich, dominant incumbents respond or have responded in the past to previous entrants. As my colleague Irwin Steltzer once put it, a no trespassing sign alone may not deter a hiker from walking on another's property, but when, just beyond the sign, the field is littered with the bodies of previous trespassers--and all the more so when other fields, owned by other people, are similarly littered--the lesson is likely to sink in. And no static calculus of the benefits and costs of such

[35] *See* X. Vives, OLIGOPOLY PRICING 291 (1999); D. Fudenberg and E. Tirole, Noncooperative Game Theory, in 1 HANDBOOK OF INDUSTRIAL ORGANIZATION 320-322 (R. Schmalensee and R. Willig, eds. 1989); J. Ordover and G. Saloner, Predation, Monopolization and Antitrust, in 1 HANDBOOK OF INDUSTRIAL ORGANIZATION 545-562 (R. Schmalensee and R. Willig, eds. 1989); D. Kreps, and R. Wilson, *Reputation and Imperfect Information*, 27 J. OF ECON. THEORY, 253-79 (1982); P. Milgrom, and J. Roberts, *Predation, Reputation and Entry Deterrence*, 27 J. OF ECON. THEORY 280-312 (1982).

> disciplinary action in an individual case, with the benefits heavily discounted because of their futurity and uncertainty, can suffice to dispel the possibility that such a policy will recommend itself to the incumbents, and end up producing a radically transformed, highly concentrated industry, far less competitive in its pricing behavior.[36]

60. *Customer Foreclosure.* The Commission has recognized a related concern that the RBOCs can use pricing flexibility to prevent facilities competition by engaging in customer foreclosure. In particular,

> [a]n incumbent can forestall the entry of potential competitors by "locking up" large customers . . . . Specifically, large customers may create the inducement for potential competitors to invest in sunk facilities . . . . To the extent the incumbent can lock in the larger . . . customers whose traffic would economically justify the construction of new facilities, the incumbents can foreclose competition for the smaller customer as well.[37]

61. The Commission's fears were well-justified from the perspective of sound economics. And there is now evidence that the pricing flexibility regulations that the Commission adopted in 1999 are not adequate to prevent this type of exclusionary conduct. As AT&T explains in its Petition, the RBOCs are effectively impelling carriers to enter into optional pricing plans ("OPPs") that tie up significant portions of the market. The RBOCs have threatened IXCs with even higher rates unless they sign long-term contracts with sizable penalties for early termination.

62. We understand that virtually all of these plans require AT&T to commit to certain levels of annual purchases to obtain the discounts. As a result, if AT&T were to migrate traffic to its own or RBOC competitors' facilities, it would lose the OPP discounts (typically on

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[36] Alfred E. Kahn, *The Macroeconomic Consequences of Sensible Microeconomic Policies*, at 14-15 (N/E/R/A Reprint, 1984).

[37] *Pricing Flexibility Order* ¶ 79.

a *regionwide* basis), which in most cases would dwarf whatever savings AT&T could achieve by using competitive alternatives. Indeed, we understand that some RBOCs have insisted on specific penalties for migrating traffic to competitors. Even if more broadly available alternatives were to eventuate, AT&T could not take advantage of them in many cases, because most of the OPP plans impose substantial penalties for early withdrawal, which would negate any savings.

63. In short, as the Commission recognized in the *Pricing Flexibility Order*, absent effective competition or regulation, the RBOCs have the ability to engage in pricing practices that make the technology-driven barriers to entry even more effective in working against new entrants. The RBOCs can ward off the threat of competitive entry by "locking up" large customers by offering them volume or term discounts below entrants' costs – thereby deterring prospective entrants, for whom service to large customers may have been the inducement necessary to invest in the necessary sunk facilities. And the evidence indicates that the RBOCs are doing precisely that.

B. Regulation Of Special Access Continues to be Necessary To Protect Long Distance Competition.

64. As the RBOCs win interLATA authority, they will have increasing incentive to use their market power in the provision of special access to disadvantage anticompetitively their long distance rivals. Access is a "necessary input for long-distance service" and access charges constitute a sizeable percentage of the overall cost of long distance services. This gives the RBOCs the opportunity to undertake a profitable strategy of raising rivals' costs.

65. More specifically, once RBOCs are permitted to provide in-region long-distance service, they will compete with the IXCs that depend on them for the provision of terminating and originating access. This provides the RBOCs with the further opportunity and incentive to weaken the IXCs' competitive position by overcharging them for access. At the same time, the increase in access charges will provide the RBOCs' long-distance affiliates with a strategic cost advantage wholly unrelated to any efficiencies realized by the affiliates. The source of these cost and competitive advantages is the difference between the true cost of access, as measured by its TELRIC, and the distorted rate that the RBOCs can charge to its access customers. This cost advantage enables the RBOC not only to charge monopoly prices for access, but to set its long-distance rates at or below its access prices.[38]

66. If access prices are above the costs that the RBOC actually incurs to provide access, the RBOC can use the cost differential between what its rivals pay them for these elements and the lower economic cost that it incurs as a vertically integrated company to gain an advantage in the provision of bundled services. The RBOC might create an anti-

[38] The Commission has long recognized that, "[a]bsent appropriate regulation, an incumbent LEC and its interexchange affiliate could potentially implement a price squeeze once the incumbent LEC began offering in-region, interexchange toll services." *Access Reform Order,* 12 FCC Rcd. 15982 ¶ 277 (1997); *see also id.* ¶ 278 (incumbents have the "incentive and ability to engage in a price squeeze"). As the Commission has explained, "[t]he incumbent ILEC could do this by raising the price of interstate access services to all interexchange carriers, which would cause the competing in-region carriers to either raise their retail rates to maintain their profit margins or to attempt to maintain their market share by not raising their prices to reflect the increase in access charges." *Id.* ¶ 277. Alternatively, "the incumbent LEC could also set its in-region, interexchange prices at or below its access prices. Its competitors would then be faced with the choice of lowering their retail rates for interexchange services, thereby reducing their profit margins, or maintaining their retail rates at the higher price and risk losing market share." *Id.*

competitive price squeeze by charging IXCs a greater margin for access than the RBOC earns on its own integrated end-user services, and thereby deter efficient IXC supply. This strategy may be profitable to the RBOCs, while harmful to consumers, and can weaken the ability of IXCs to compete for local exchange business while maintaining the monopoly hold that the RBOCs have over that business.

67. Such ILEC tactics harm not only IXCs, but also telecommunications consumers. As long as the RBOC continues to charge and collect excessive access prices, it is the end users who will continue to pay for them in one way or another. One avenue is simply the passed-along amount that the end-user pays to the IXC, so that the IXC can in turn pay it to the RBOC. Another avenue is the above-cost price for long-distance charged to the end-user by the RBOC.

68. Consumers are also harmed because an anticompetitive price squeeze impairs the IXC's ability to compete for the provision of bundled offerings that contain both a local and long distance component. By maintaining above-cost access charges, the RBOC can continue to apply strong pressure on IXCs, who must charge customers long-distance prices that reflect the excessive charges. By charging prices for its long-distance customers that do not reflect all of the artificially elevated access prices, the RBOC can divert substantial business from the IXCs to itself.

69. The evidence since 1999 confirms that the Bells not only can undertake such anticompetitive price squeezes, but may have actually done so. For example, AT&T has shown that SBC maintains intrastate access rates in Texas of nearly six cents per minute

(originating plus terminating).[39] SBC's long distance affiliate, however, offers long distance rates in Texas as low as five cents per minute, as well as a block of 100 minutes for six dollars.[40] Because providing finished long distance service requires SBC to incur many additional costs (such as the intraLATA transport component, retail and marketing, and back office expenses), SBC's long distance affiliate must be offering retail services that fail to cover SBC's properly imputed costs. For an example that highlights the potential roles of bundling, BellSouth offers an intrastate service in its region called "Fast Packet Option." Under this offer, end users can obtain special access at rates that are lower than those in BellSouth's federal tariffs, but only if the end user agrees to purchase BellSouth's frame relay services as well.[41] As a result, AT&T cannot obtain special access at the "Fast Packet Option" rates and pair that service with its own frame relay services.

VI. CONCLUSION

70. For the reasons stated, the triggers established by the *Pricing Flexibility Order* fail to ensure that, absent regulation, an RBOC granted such flexibility would be unable to exercise market power over the access services for which pricing flexibility is authorized. Instead, the triggers have enabled the RBOCs to reap supracompetitive profits and freed the RBOCs to abuse their control of critical inputs in order to deter efficient entry into the

[39] Comments of AT&T Corp., CC Docket No. 00-175, at 4 (Nov. 1, 2001).

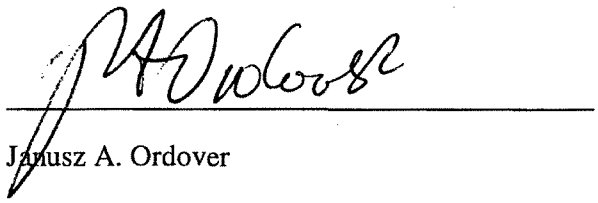
[40] *Id.*

[41] *Compare* BellSouth Telecommunications Inc., Georgia, General Subscriber Service Tariff, Twelfth Revised Page 1, A.40 (Frame Relay Service), *with* BellSouth Telecommunications, Inc., FCC Tariff No. 1, 6th Revised page 21-1 (Fast Packet Access Services). BellSouth has similar tariffs in each of the states in its region.

access markets and impede competition in long distance markets. Such consequences are plainly contrary to the public interest. We therefore recommend that the Commission subject the RBOCs' special access services to effective regulation that will drive access charges towards cost and constrain exclusionary conduct by the RBOCs.

VERIFICATION

I, Janusz A. Ordover, declare under penalty of perjury that the foregoing is true and correct. Executed on November 7, 2002.



Janusz A. Ordover

VERIFICATION

I, Robert Willig, declare under penalty of perjury that the foregoing is true and correct.

Executed on October 14, 2002.

Robert Willig

TAB C

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington D.C. 20554

In the Matter of	)	
AT&T Corp.	)	WC Docket No. 02-____
Petition for Rulemaking To Reform Regulation Of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services	)	

DECLARATION OF M. JOSEPH STITH

1. My name is M. Joseph Stith. I am an analyst at AT&T. My responsibilities include analysis of ILEC Special Access. I obtained a Ph.D. in Mathematical Statistics from the University of Missouri in 1978.

2. I have prepared the attached charts, which provide a comparison of each Bell company's tariffed interstate special access rates subject to price caps with their tariffed interstate rates subject to pricing flexibility in each state. The charts also provide a comparison of those rates to the rates for comparable unbundled network elements in each state.

3. I computed the rates as follows. All rates are for a ten-mile stand-alone circuit, to facilitate apples-to-apples comparisons. In other words, each rate is for two channel terminations, a fixed mileage charge for transport, and per-mile charge for transport

(multiplied by ten). In any instance in which the ILEC has zoned rates, I used the Zone 1 rate. All rates are as of August 1, 2002.

4. "ILEC Tariff" is the ILEC's tariffed month-to-month rate for a ten-mile standalone circuit for special access services still subject to price caps.

5. "ILEC OPP" is the ILEC's tariffed rate for a ten-mile standalone circuit provided in its optional pricing plan ("OPP"), for services still subject to price caps. All OPP rates are for five-year plans, except where not available, in which case the highest year plan below five years was used.[1]

6. "ILEC Pricing Flex Tariff" is the ILEC's tariffed month-to-month rate for a ten-mile standalone circuit for special access services no longer subject to price caps.

7. "ILEC Pricing Flex OPP" is the ILEC's tariffed rate for a ten-mile standalone circuit provided in its OPP for services no longer subject to price caps.

8. "Month-to-Month Difference Pricing Flex to Price Cap" is the percentage difference between the price capped month-to-month rate and the pricing flexibility month-to-month rate (*i.e.*, the percentage difference between the rates in columns 1 and 3).

9. "OPP % Difference Pricing Flex to Price Cap" is the percentage difference between the price capped OPP rate and the pricing flexibility OPP rate (*i.e.*, the percentage difference between the rates in columns 2 and 4).

[1] "ILEC OPP" does not include payment plans requiring commitment either to an expense level or to a level of expense growth.

10. "UNE rate" is the rate for a loop and transport combination in that state, assuming a ten-mile circuit. The chart displays UNE rates only where such rates are ordered and effective as determined by a state commission.

11. As the data demonstrate, the Bells' tariffed pricing flexibility rates are equal to or higher than their tariffed price cap rates in virtually every instance. For example, for DS1 OPP rates – which represent the largest volumes and the largest expense – SBC-Southwestern Bell's pricing flexibility rates are more than 35% higher than the price cap rates, SBC-Pacific Bell's are 24% higher, Verizon-Bell Atlantic-South's are 16% higher, and Verizon-Bell Atantic-North's are 7% to 14% higher (depending on the state). Notably, the Bells charge these higher rates in the largest cities in the United States, where competition is ostensibly the most advanced. Many of the Bells' other special access services show similar disparities.

Exhibit 1

10/8/2002

Comparison of costs (10-mile Standalone Circuit)

Company State

BellSouth Alabama

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$505	$380	$601	$391	19%	3%	$220
DS3	$7,210	$4,075	$8,180	$4,575	13%	12%	$1,485
DS-0 Digital	$284	$202	$284	$202	0%	0%	$64
DS-0 Analog	$151	$110	$151	$110	0%	0%	$64
OC-3	$11,630	$9,520	$11,980	$9,600	3%	1%	
OC-12	$23,990	$19,810	$24,440	$19,450	2%	-2%	
OC-48	$50,000	$40,500	$50,200	$38,600	0%	-5%	
OC-192	$129,500	$104,100	$129,500	$95,700	0%	-8%	

BellSouth Georgia

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$505	$380	$601	$391	19%	3%	$177
DS3	$7,210	$4,075	$8,180	$4,575	13%	12%	$1,737
DS-0 Digital	$284	$202	$284	$202	0%	0%	$54
DS-0 Analog	$151	$110	$151	$110	0%	0%	$54
OC-3	$11,630	$9,520	$11,980	$9,600	3%	1%	
OC-12	$23,990	$19,810	$24,440	$19,450	2%	-2%	
OC-48	$50,000	$40,500	$50,200	$38,600	0%	-5%	
OC-192	$129,500	$104,100	$129,500	$95,700	0%	-8%	

BellSouth Florida

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$505	$380	$601	$391	19%	3%	$198
DS3	$7,210	$4,075	$8,180	$4,575	13%	12%	$2,070
DS-0 Digital	$284	$202	$284	$202	0%	0%	$61
DS-0 Analog	$151	$110	$151	$110	0%	0%	$61
OC-3	$11,630	$9,520	$11,980	$9,600	3%	1%	
OC-12	$23,990	$19,810	$24,440	$19,450	2%	-2%	
OC-48	$50,000	$40,500	$50,200	$38,600	0%	-5%	
OC-192	$129,500	$104,100	$129,500	$95,700	0%	-8%	

10/8/2002

Comparison of costs (10-mile Standalone Circuit)

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
BellSouth	North Carolina	DS1	$505	$380	$601	$391	19%	3%	$176
		DS3	$7,210	$4,075	$8,180	$4,575	13%	12%	$1,772
		DS-0 Digital	$284	$202	$284	$202	0%	0%	$61
		DS-0 Analog	$151	$110	$151	$110	0%	0%	$61
		OC-3	$11,630	$9,520	$11,980	$9,600	3%	1%	
		OC-12	$23,990	$19,810	$24,440	$19,450	2%	-2%	
		OC-48	$50,000	$40,500	$50,200	$38,600	0%	-5%	
		OC-192	$129,500	$104,100	$129,500	$95,700	0%	-8%	

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
BellSouth	South Carolina	DS1	$505	$380	$601	$391	19%	3%	$183
		DS3	$7,210	$4,075	$8,180	$4,575	13%	12%	Local Ch N/A
		DS-0 Digital	$284	$202	$284	$202	0%	0%	$63
		DS-0 Analog	$151	$110	$151	$110	0%	0%	$63
		OC-3	$11,630	$9,520	$11,980	$9,600	3%	1%	
		OC-12	$23,990	$19,810	$24,440	$19,450	2%	-2%	
		OC-48	$50,000	$40,500	$50,200	$38,600	0%	-5%	
		OC-192	$129,500	$104,100	$129,500	$95,700	0%	-8%	

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
BellSouth	Mississippi	DS1	$505	$380	$601	$391	19%	3%	$169
		DS3	$7,210	$4,075	$8,180	$4,575	13%	12%	$1,450
		DS-0 Digital	$284	$202	$284	$202	0%	0%	$59
		DS-0 Analog	$151	$110	$151	$110	0%	0%	$59
		OC-3	$11,630	$9,520	$11,980	$9,600	3%	1%	
		OC-12	$23,990	$19,810	$24,440	$19,450	2%	-2%	
		OC-48	$50,000	$40,500	$50,200	$38,600	0%	-5%	
		OC-192	$129,500	$104,100	$129,500	$95,700	0%	-8%	

10/8/2002

Comparison of costs (10-mile Standalone Circuit)

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
BellSouth	Louisiana	DS1	$505	$380	$601	$391	19%	3%	$224
		DS3	$7,210	$4,075	$8,180	$4,575	13%	12%	$1,760
		DS-0 Digital	$284	$202	$284	$202	0%	0%	$75
		DS-0 Analog	$151	$110	$151	$110	0%	0%	$75
		OC-3	$11,630	$9,520	$11,980	$9,600	3%	1%	
		OC-12	$23,990	$19,810	$24,440	$19,450	2%	-2%	
		OC-48	$50,000	$40,500	$50,200	$38,600	0%	-5%	
		OC-192	$129,500	$104,100	$129,500	$95,700	0%	-8%	

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
BellSouth	Tennessee	DS1	$505	$380	$601	$391	19%	3%	$175
		DS3	$7,210	$4,075	$8,180	$4,575	13%	12%	$1,918
		DS-0 Digital	$284	$202	$284	$202	0%	0%	$61
		DS-0 Analog	$151	$110	$151	$110	0%	0%	$61
		OC-3	$11,630	$9,520	$11,980	$9,600	3%	1%	
		OC-12	$23,990	$19,810	$24,440	$19,450	2%	-2%	
		OC-48	$50,000	$40,500	$50,200	$38,600	0%	-5%	
		OC-192	$129,500	$104,100	$129,500	$95,700	0%	-8%	

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
BellSouth	Kentucky	DS1	$505	$380	$601	$391	19%	3%	$191
		DS3	$7,210	$4,075	$8,180	$4,575	13%	12%	$2,127
		DS-0 Digital	$284	$202	$284	$202	0%	0%	$70
		DS-0 Analog	$151	$110	$151	$110	0%	0%	$70
		OC-3	$11,630	$9,520	$11,980	$9,600	3%	1%	
		OC-12	$23,990	$19,810	$24,440	$19,450	2%	-2%	
		OC-48	$50,000	$40,500	$50,200	$38,600	0%	-5%	
		OC-192	$129,500	$104,100	$129,500	$95,700	0%	-8%	

Notes:

1 DS3 assumed POP channel term and the end-user channel term are between 1/2 and 1 mile of their LEC serving wire centers.
2 OC-n not offered at month-to-month rates, used 1-year term plan for Tariff pricing. Mileage is offered at month-to-month rates, but continued to use 1-vear term plan.
3 Used OC-n 4-wire for interface rates.
4 OC-n assumed both channel terms within 1/2 mi of their respective LSOs.
5 OC-192 did not have interface rates leisted in the tariff, used 4 times the OC-48 rates.
6 Used 61-month term plans for all services.
7 DS3: Assumed a 1-mile end-user and POP channel term.

10/8/2002

Comparison of costs (10-mile Standalone Circuit)

Company State

Qwest Arizona

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$420	$326	$440	$342	5%	5%	$371
DS3	$3,710	$2,783	$3,710	$2,783	0%	0%	$4,376
DS-0 Digital	$175	$140	$186	$149	6%	6%	Mileage N/A
DS-0 Analog	$87	$79	$90	$82	3%	4%	Mileage N/A
OC-3					N/A	N/A	N/A
OC-12					N/A	N/A	N/A
OC-48					N/A	N/A	N/A
OC-192					N/A	N/A	N/A

Qwest Colorado

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$420	$326	$440	$342	5%	5%	$153
DS3	$3,710	$2,783	$3,710	$2,783	0%	0%	$1,131
DS-0 Digital	$175	$140	$186	$149	6%	6%	Mileage N/A
DS-0 Analog	$87	$79	$90	$82	3%	4%	Mileage N/A
OC-3					N/A	N/A	N/A
OC-12					N/A	N/A	N/A
OC-48					N/A	N/A	N/A
OC-192					N/A	N/A	N/A

Qwest Iowa

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$420	$326	$440	$342	5%	5%	Loop N/A
DS3	$3,710	$2,783	$3,710	$2,783	0%	0%	Loop N/A
DS-0 Digital	$175	$140	$186	$149	6%	6%	Mileage N/A
DS-0 Analog	$87	$79	$90	$82	3%	4%	Mileage N/A
OC-3					N/A	N/A	N/A
OC-12					N/A	N/A	N/A
OC-48					N/A	N/A	N/A
OC-192					N/A	N/A	N/A

10/8/2002

Comparison of costs (10-mile Standalone Circuit)

Company State

Qwest Idaho

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$440	$342	$460	$358	5%	4%	Loop & Mi N/A
DS3	$3,710	$2,783	$3,710	$2,783	0%	0%	Loop & Mi N/A
DS-0 Digital	$175	$140	$186	$149	6%	6%	Loop & Mi N/A
DS-0 Analog	$87	$79	$90	$82	3%	4%	Loop & Mi N/A
OC-3					N/A	N/A	
OC-12					N/A	N/A	
OC-48					N/A	N/A	
OC-192					N/A	N/A	

Qwest Minnesota

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$420	$326	$440	$342	5%	5%	Loop N/A
DS3	$3,710	$2,783	$3,710	$2,783	0%	0%	Loop N/A
DS-0 Digital	$175	$140	$186	$149	6%	6%	Loop & Mi N/A
DS-0 Analog	$87	$79	$90	$82	3%	4%	Loop & Mi N/A
OC-3					N/A	N/A	N/A
OC-12					N/A	N/A	N/A
OC-48					N/A	N/A	N/A
OC-192					N/A	N/A	N/A

Qwest Montana

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$440	$342	$460	$358	5%	4%	Loop & Mi N/A
DS3	$3,710	$2,783	$3,710	$2,783	0%	0%	Loop & Mi N/A
DS-0 Digital	$175	$140	$186	$149	6%	6%	Loop & Mi N/A
DS-0 Analog	$87	$79	$90	$82	3%	4%	Loop & Mi N/A
OC-3					N/A	N/A	N/A
OC-12					N/A	N/A	N/A
OC-48					N/A	N/A	N/A
OC-192					N/A	N/A	N/A

10/8/2002

Comparison of costs (10-mile Standalone Circuit)

Company: Qwest — State: North Dakota

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$440	$342	$460	$358	5%	4%	Loop & Mi N/A
DS3	$3,710	$2,783	$3,710	$2,783	0%	0%	Loop & Mi N/A
DS-0 Digital	$175	$140	$186	$149	6%	6%	Loop & Mi N/A
DS-0 Analog	$87	$79	$90	$82	3%	4%	Loop & Mi N/A
OC-3					N/A	N/A	
OC-12					N/A	N/A	
OC-48					N/A	N/A	
OC-192					N/A	N/A	

Company: Qwest — State: Nebraska

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$420	$326	$440	$342	5%	5%	$227
DS3	$3,710	$2,783	$3,710	$2,783	0%	0%	$1,677
DS-0 Digital	$175	$140	$186	$149	6%	6%	Mileage N/A
DS-0 Analog	$87	$79	$90	$82	3%	4%	Mileage N/A
OC-3					N/A	N/A	N/A
OC-12					N/A	N/A	N/A
OC-48					N/A	N/A	N/A
OC-192					N/A	N/A	N/A

Company: Qwest — State: New Mexico

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$420	$326	$440	$342	5%	5%	Loop & Mi N/A
DS3	$3,710	$2,783	$3,710	$2,783	0%	0%	Loop & Mi N/A
DS-0 Digital	$175	$140	$186	$149	6%	6%	Mileage N/A
DS-0 Analog	$87	$79	$90	$82	3%	4%	Mileage N/A
OC-3					N/A	N/A	
OC-12					N/A	N/A	
OC-48					N/A	N/A	
OC-192					N/A	N/A	

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Comparison of costs (10-mile Standalone Circuit)

Company: Qwest — State: Oregon

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$420	$326	$440	$342	5%	5%	$221
DS3	$3,710	$2,783	$3,710	$2,783	0%	0%	$1,082
DS-0 Digital	$175	$140	$186	$149	6%	6%	Mileage N/A
DS-0 Analog	$87	$79	$90	$82	3%	4%	Mileage N/A
OC-3					N/A	N/A	N/A
OC-12					N/A	N/A	N/A
OC-48					N/A	N/A	N/A
OC-192					N/A	N/A	N/A

Company: Qwest — State: South Dakota

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$440	$342	$460	$358	5%	4%	Loop & Mi N/A
DS3	$3,710	$2,783	$3,710	$2,783	0%	0%	Loop & Mi N/A
DS-0 Digital	$175	$140	$186	$149	6%	6%	Loop & Mi N/A
DS-0 Analog	$87	$79	$90	$82	3%	4%	Loop & Mi N/A
OC-3					N/A	N/A	N/A
OC-12					N/A	N/A	N/A
OC-48					N/A	N/A	N/A
OC-192					N/A	N/A	N/A

Company: Qwest — State: Utah

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$420	$326	$440	$342	5%	5%	Loop & Mi N/A
DS3	$3,710	$2,783	$3,710	$2,783	0%	0%	Loop & Mi N/A
DS-0 Digital	$175	$140	$186	$149	6%	6%	Loop & Mi N/A
DS-0 Analog	$87	$79	$90	$82	3%	4%	Loop & Mi N/A
OC-3					N/A	N/A	
OC-12					N/A	N/A	
OC-48					N/A	N/A	
OC-192					N/A	N/A	

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Comparison of costs (10-mile Standalone Circuit)

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
Qwest	Washington	DS1	$420	$326	$440	$342	5%	5%	Loop & Mi N/A
		DS3	$3,710	$2,783	$3,710	$2,783	0%	0%	Loop & Mi N/A
		DS-0 Digital	$175	$140	$186	$149	6%	6%	Mileage N/A
		DS-0 Analog	$87	$79	$90	$82	3%	4%	Mileage N/A
		OC-3					N/A	N/A	
		OC-12					N/A	N/A	
		OC-48					N/A	N/A	
		OC-192					N/A	N/A	

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
Qwest	Wyoming	DS1	$440	$342	$460	$358	5%	4%	Loop & Mi N/A
		DS3	$3,710	$2,783	$3,710	$2,783	0%	0%	Loop & Mi N/A
		DS-0 Digital	$175	$140	$186	$149	6%	6%	Loop & Mi N/A
		DS-0 Analog	$87	$79	$90	$82	3%	4%	Loop & Mi N/A
		OC-3					N/A	N/A	N/A
		OC-12					N/A	N/A	N/A
		OC-48					N/A	N/A	N/A
		OC-192					N/A	N/A	N/A

1 DS3: Assumed a 1-mile end-user and POP channel term.

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Comparison of costs (10-mile Standalone Circuit)

Company State

SBC:Ameritech Illinois

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$974	$346	$974	$371	0%	7%	$201
DS3	$9,460	$2,480	$9,460	$2,736	0%	10%	$1,966
DS-0 Digital	$250	$141	$268	$158	7%	12%	Mileage N/A
DS-0 Analog	$90	$67	$112	$92	24%	37%	Mileage N/A
OC-3	$7,788	$5,050	$7,788	$5,000	0%	-1%	
OC-12	$16,848	$8,520	$16,848	$10,720	0%	26%	
OC-48	$28,846	$16,000	$28,846	$17,180	0%	7%	
OC-192					N/A	N/A	

SBC:Ameritech Indiana

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$1,025	$373	$1,025	$392	0%	5%	$142
DS3	$9,750	$2,580	$9,750	$2,830	0%	10%	$1,790
DS-0 Digital	$250	$141	$268	$158	7%	12%	Loop & Mi N/A
DS-0 Analog	$90	$67	$112	$92	24%	37%	Loop & Mi N/A
OC-3	$7,788	$5,050	$7,788	$5,000	0%	-1%	
OC-12	$16,848	$8,520	$16,848	$10,720	0%	26%	
OC-48	$28,846	$16,000	$28,846	$17,180	0%	7%	
OC-192					N/A	N/A	

SBC:Ameritech Michigan

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$1,002	$361	$1,002	$382	0%	6%	$94
DS3	$9,610	$2,530	$9,610	$2,793	0%	10%	$962
DS-0 Digital	$250	$141	$268	$158	7%	12%	Mileage N/A
DS-0 Analog	$90	$67	$112	$92	24%	37%	Mileage N/A
OC-3	$7,788	$5,050	$7,788	$5,000	0%	-1%	
OC-12	$16,848	$8,520	$16,848	$10,720	0%	26%	
OC-48	$28,846	$16,000	$28,846	$17,180	0%	7%	
OC-192					N/A	N/A	

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Comparison of costs (10-mile Standalone Circuit)

Company State

SBC:Ameritech Ohio

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$1,002	$361	$1,002	$382	0%	6%	$184
DS3	$9,610	$2,530	$9,610	$2,793	0%	10%	$1,888
DS-0 Digital	$250	$141	$268	$158	7%	12%	Mileage N/A
DS-0 Analog	$90	$67	$112	$92	24%	37%	Mileage N/A
OC-3	$7,788	$5,050	$7,788	$5,000	0%	-1%	
OC-12	$16,848	$8,520	$16,848	$10,720	0%	26%	
OC-48	$28,846	$16,000	$28,846	$17,180	0%	7%	
OC-192					N/A	N/A	

SBC:Ameritech Wisconsin

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$1,025	$373	$1,025	$392	0%	5%	$190
DS3	$9,750	$2,580	$9,750	$2,830	0%	10%	$2,316
DS-0 Digital	$250	$141	$268	$158	7%	12%	Mileage N/A
DS-0 Analog	$90	$67	$112	$92	24%	37%	Mileage N/A
OC-3	$7,788	$5,050	$7,788	$5,000	0%	-1%	
OC-12	$16,848	$8,520	$16,848	$10,720	0%	26%	
OC-48	$28,846	$16,000	$28,846	$17,180	0%	7%	
OC-192					N/A	N/A	

Notes:

1 Fixed mileage rates in the tariff were doubled as they are in ABC: Ameritech's billing.
2 OC-n must be purchased as an OPP, when the OPP expires, monthly extension rates are charged. The Tariff prices used these monthly extension rates.
3 DS0-Digital, used Base Rate prices.

10/8/2002

Company State

SBC: Pac Bell California

Comparison of costs (10-mile Standalone Circuit)

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$398	$275	$411	$340	3%	24%	$231
DS3	$5,680	$2,480	$5,810	$2,750	2%	11%	Loop N/A
DS-0 Digital	$155	$155	$194	$194	25%	25%	$73
DS-0 Analog	$75	$75	$86	$86	15%	15%	$73
OC-3					N/A	N/A	
OC-12					N/A	N/A	
OC-48					N/A	N/A	
OC-192					N/A	N/A	

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Comparison of costs (10-mile Standalone Circuit)

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
SBC:SWBT	Arkansas	DS1	$577	$265	$588	$368	2%	39%	$258
		DS3	$5,525	$2,600	$5,625	$2,850	2%	10%	Loop N/A
		DS-0 Digital	$163	$106	$198	$144	21%	36%	$106
		DS-0 Analog	$82	$63	$108	$81	33%	29%	$106
		OC-3	$11,050	$5,400			N/A	N/A	
		OC-12	$26,030	$14,900			N/A	N/A	
		OC-48					N/A	N/A	
		OC-192					N/A	N/A	

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
SBC:SWBT	Kansas	DS1	$577	$265	$588	$368	2%	39%	$258
		DS3	$5,525	$2,600	$5,625	$2,850	2%	10%	Loop & Mi N/A
		DS-0 Digital	$163	$106	$198	$144	21%	36%	$106
		DS-0 Analog	$82	$63	$108	$81	33%	29%	$106
		OC-3	$11,050	$5,400			N/A	N/A	
		OC-12	$26,030	$14,900			N/A	N/A	
		OC-48					N/A	N/A	
		OC-192					N/A	N/A	

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
SBC:SWBT	Missouri	DS1	$577	$265	$588	$364	2%	37%	$294
		DS3	$5,525	$2,600	$5,625	$2,850	2%	10%	Loop & Mi N/A
		DS-0 Digital	$163	$106	$198	$144	21%	36%	$58
		DS-0 Analog	$82	$63	$108	$81	33%	29%	$58
		OC-3	$11,050	$5,400			N/A	N/A	
		OC-12	$26,030	$14,900			N/A	N/A	
		OC-48					N/A	N/A	
		OC-192					N/A	N/A	

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Comparison of costs (10-mile Standalone Circuit)

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
SBC:SWBT	Oklahoma								
		DS1	$577	$265	$588	$368	2%	39%	$437
		DS3	$5,525	$2,600	$5,625	$2,850	2%	10%	Loop N/A
		DS-0 Digital	$163	$106	$198	$144	21%	36%	$134
		DS-0 Analog	$82	$63	$108	$81	33%	29%	$134
		OC-3	$11,050	$5,400			N/A	N/A	
		OC-12	$26,030	$14,900			N/A	N/A	
		OC-48					N/A	N/A	
		OC-192					N/A	N/A	

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
SBC:SWBT	Texas								
		DS1	$577	$265	$577	$360	0%	36%	$245
		DS3	$5,525	$2,600	$5,625	$2,850	2%	10%	Loop & Mi N/A
		DS-0 Digital	$163	$106	$198	$144	21%	36%	$54
		DS-0 Analog	$82	$63	$108	$81	33%	29%	$54
		OC-3	$11,050	$5,400			N/A	N/A	
		OC-12	$26,030	$14,900			N/A	N/A	
		OC-48					N/A	N/A	
		OC-192					N/A	N/A	

Notes: 1 OC-n not offered at month-to-month rates, used 1-year term plan for Tariff pricing

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Comparison of costs (10-mile Standalone Circuit)

Company: Verizon: Bell Atlantic-North — State: Maine

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$801	$521	$915	$595	14%	14%	$291
DS3	$6,126	$3,982	$6,501	$3,982	6%	0%	$2,283
DS-0 Digital	$209	$167	$274	$219	31%	31%	Mileage N/A
DS-0 Analog	$182	$146	$241	$193	32%	32%	Mileage N/A
OC-3					N/A	N/A	
OC-12					N/A	N/A	
OC-48					N/A	N/A	
OC-192					N/A	N/A	

Verizon: Bell Atlantic-North — New Hampshire

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$801	$521	$915	$595	14%	14%	$339
DS3	$6,126	$3,982	$6,501	$3,982	6%	0%	$2,089
DS-0 Digital	$209	$167	$274	$219	31%	31%	Mileage N/A
DS-0 Analog	$182	$146	$241	$193	32%	32%	Mileage N/A
OC-3					N/A	N/A	
OC-12					N/A	N/A	
OC-48					N/A	N/A	
OC-192					N/A	N/A	

Verizon: Bell Atlantic-North — Vermont

Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
DS1	$801	$521	$915	$595	14%	14%	$185
DS3	$6,126	$3,982	$6,501	$3,982	6%	0%	$2,124
DS-0 Digital	$209	$167	$274	$219	31%	31%	Mileage N/A
DS-0 Analog	$182	$146	$241	$193	32%	32%	Mileage N/A
OC-3					N/A	N/A	
OC-12					N/A	N/A	
OC-48					N/A	N/A	
OC-192					N/A	N/A	

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Comparison of costs (10-mile Standalone Circuit)

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
Verizon: Bell Atlantic-North	Massachusetts	DS1	$729	$474	$780	$507	7%	7%	$286
		DS3	$5,785	$3,760	$6,126	$3,760	6%	0%	$2,900
		DS-0 Digital	$209	$167	$274	$219	31%	31%	Mileage N/A
		DS-0 Analog	$182	$146	$241	$193	32%	32%	Mileage N/A
		OC-3					N/A	N/A	
		OC-12					N/A	N/A	
		OC-48					N/A	N/A	
		OC-192					N/A	N/A	
Verizon: Bell Atlantic-North	Rhode Island	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
		DS1	$801	$521	$915	$595	14%	14%	$435
		DS3	$6,126	$3,982	$6,501	$3,982	6%	0%	$2,551
		DS-0 Digital	$209	$167	$274	$219	31%	31%	Mileage N/A
		DS-0 Analog	$182	$146	$241	$193	32%	32%	Mileage N/A
		OC-3					N/A	N/A	
		OC-12					N/A	N/A	
		OC-48					N/A	N/A	
		OC-192					N/A	N/A	
Verizon: Bell Atlantic-North	New York	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
		DS1	$671	$436	$716	$466	7%	7%	$272
		DS3	$5,785	$3,760	$6,126	$3,760	6%	0%	$2,518
		DS-0 Digital	$209	$167	$266	$212	27%	27%	Mileage N/A
		DS-0 Analog	$182	$146	$241	$193	32%	32%	Mileage N/A
		OC-3					N/A	N/A	
		OC-12					N/A	N/A	
		OC-48					N/A	N/A	
		OC-192					N/A	N/A	

Notes:

1 DS3 Channel Term are priced based on the number of DS3 channels, both channel terms and entrance facilities, from the specific LEC LSO to the specific customer designated premises. Used count of 25+ (AT&T's modal value, near the lowest value) for the POP channel term rate and count of 1 (highest rate) for the end-user.

2 DS0-Digital, used Digipath II prices.

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Comparison of costs (10-mile Standalone Circuit)

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
Verizon: Bell Atlantic-South	Delaware	DS1	$657	$405	$780	$469	19%	16%	$279
		DS3	$6,143	$3,993	$6,881	$4,046	12%	1%	$598
		DS-0 Digital	$320	$173	$409	$222	28%	28%	$48
		DS-0 Analog	$109	$93	$148	$125	37%	35%	$48
		OC-3					N/A	N/A	
		OC-12					N/A	N/A	
		OC-48					N/A	N/A	
		OC-192					N/A	N/A	
Verizon: Bell Atlantic-South	New Jersey	DS1	$657	$405	$780	$469	19%	16%	$170
		DS3	$6,143	$3,993	$6,881	$4,046	12%	1%	$1,957
		DS-0 Digital	$320	$173	$409	$222	28%	28%	$56
		DS-0 Analog	$109	$93	$148	$125	37%	35%	$56
		OC-3					N/A	N/A	
		OC-12					N/A	N/A	
		OC-48					N/A	N/A	
		OC-192					N/A	N/A	
Verizon: Bell Atlantic-South	Pennsylvania	DS1	$657	$405	$780	$469	19%	16%	$277
		DS3	$6,143	$3,993	$6,881	$4,046	12%	1%	$2,490
		DS-0 Digital	$320	$173	$409	$222	28%	28%	$50
		DS-0 Analog	$109	$93	$148	$125	37%	35%	$50
		OC-3					N/A	N/A	
		OC-12					N/A	N/A	
		OC-48					N/A	N/A	
		OC-192					N/A	N/A	

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Comparison of costs (10-mile Standalone Circuit)

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
Verizon: Bell Atlantic-South	Maryland	DS1	$657	$405	$780	$469	19%	16%	$260
		DS3	$6,143	$3,993	$6,881	$4,046	12%	1%	$519
		DS-0 Digital	$320	$173	$409	$222	28%	28%	$58
		DS-0 Analog	$109	$93	$148	$125	37%	35%	$58
		OC-3					N/A	N/A	
		OC-12					N/A	N/A	
		OC-48					N/A	N/A	
		OC-192					N/A	N/A	

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
Verizon: Bell Atlantic-South	Virginia	DS1	$657	$405	$780	$469	19%	16%	$256
		DS3	$6,143	$3,993	$6,881	$4,046	12%	1%	$605
		DS-0 Digital	$320	$173	$409	$222	28%	28%	$54
		DS-0 Analog	$109	$93	$148	$125	37%	35%	$54
		OC-3					N/A	N/A	
		OC-12					N/A	N/A	
		OC-48					N/A	N/A	
		OC-192					N/A	N/A	

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
Verizon: Bell Atlantic-South	DC	DS1	$657	$405	$780	$469	19%	16%	$596
		DS3	$6,143	$3,993	$6,881	$4,046	12%	1%	$2,417
		DS-0 Digital	$320	$173	$409	$222	28%	28%	$78
		DS-0 Analog	$109	$93	$148	$125	37%	35%	$78
		OC-3					N/A	N/A	
		OC-12					N/A	N/A	
		OC-48					N/A	N/A	
		OC-192					N/A	N/A	

10/8/2002

Comparison of costs (10-mile Standalone Circuit)

Company	State	Sevice	ILEC Tariff Mo-to-Mo	ILEC OPP	ILEC Pricing Flex Tariff	ILEC Pricing Flex OPP	Mo-to-Mo % Difference Pricing Flex to Price Cap	OPP % Difference Pricing Flex to Price Cap	UNE rate
Verizon: Bell Atlantic-South	West Virginia	DS1	$657	$405	$780	$469	19%	16%	$275
		DS3	$6,143	$3,993	$6,881	$4,046	12%	1%	$798
		DS-0 Digital	$320	$173	$409	$222	28%	28%	$50
		DS-0 Analog	$109	$93	$148	$125	37%	35%	$50
		OC-3					N/A	N/A	
		OC-12					N/A	N/A	
		OC-48					N/A	N/A	
		OC-192					N/A	N/A	

Notes:

1 DS3 Channel Term are priced based on the number of DS3 channels, both channel terms and entrance facilities, from the specific LEC LSO to the specific customer designated premises. Used count of 25+ (AT&T's modal value, near the lowest value) for the POP channel term rate and count of 1 (highest rate) for the end-user.

I, M. Joseph Stith, declare under penalty of perjury that the foregoing is true and correct.

M. Joseph Stith

M. Joseph Stith

Executed on October 7, 2002.

LINDA A. ESPOSITO
NOTARY PUBLIC OF NEW JERSEY
My Commission Expires Sept.18, 2006

Linda A. Esposito

TAB D

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington D.C. 20554

In the Matter of AT&T Corp. Petition for Rulemaking To Reform Regulation Of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services	)	WC Docket No. 02-____

DECLARATION OF KENNETH THOMAS

1. My name is Kenneth Thomas. I am Local and Access Management Business Development Vice President at AT&T Corp. ("AT&T"). I have previous experience in sales, marketing, network planning and network engineering. I have a BS in Marketing from Kean College.

2. One of my responsibilities at AT&T is to lead a team that is charged with identifying and negotiating facilities-based alternatives to the incumbent local exchange carriers' ("ILEC") access services. AT&T prefers to obtain access services from sources other than the monopoly ILECs, and my team has invested great effort to find such alternatives.

3. Very few such alternatives exist. Today, AT&T serves approximately 186,000 buildings using special access services. Of that 186,000, approximately 6,000 buildings are served using AT&T's facilities, and another approximately 3,700 buildings are served by CLECs. AT&T must rely on the ILECs' special access services for the

remaining buildings. In other words, AT&T reaches only about 5% of the buildings it serves by using its own or CLEC facilities (in whole or in part).

4. AT&T looks to two principal alternatives for access services. First, whenever possible, AT&T obtains facilities-based connectivity to end-user buildings from AT&T's Local Network Services ("LNS"). As AT&T has explained in detail in declarations filed in the Triennial Review proceeding, LNS is able to establish connectivity to only a small fraction of buildings. As those declarations demonstrate, AT&T serves only about 6,000 buildings through its own facilities, which represents a small percentage of the T1 equivalents AT&T serves. Moreover, in a substantial percentage of cases, those facilities are in a "fiber to the floor" arrangement – *i.e.*, those facilities cannot be used today to serve other customers in those same buildings. *See Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, et al.*, CC Docket Nos. 01-339 *et al.*, Comments of AT&T, Declaration of Michael E. Lesher and Robert J. Frontera, ¶¶ 16-30, 33-36, 41-43 (filed April 5, 2002); *id.*, Reply Comments of AT&T, Declaration of Anthony Fea and Anthony Giovannucci, ¶¶ 59-68 (filed July 17, 2002). Thus, even in the 6,000 buildings in which AT&T has facilities, AT&T still must rely in part on ILEC special access services in most cases.

5. If AT&T's LNS does not have a facilities-based connection to a building, AT&T seeks facilities-based connections from other competitive local exchange carriers ("CLECs"). My team has investigated numerous CLECs' facilities-based offerings, and AT&T has entered into agreements with a number of CLECs that meet AT&T's criteria of service quality, performance measures, and cost effectiveness. AT&T has entered into

agreements with virtually every major CLEC, including MFS/WorldCom, Adelphia, and Time Warner.

6. These CLECs, however, have established alternative facilities to a small fraction of buildings. Indeed, these CLECs together offer AT&T access to an additional approximately 14,000 buildings nationwide, and AT&T actually purchases some access services from these CLECs to about 3,700 buildings. Thus, AT&T achieves at least partial bypass of the ILECs' special access services in about 5% of the buildings in which it purchases special access.[1] Moreover, AT&T uses CLEC special access facilities for only a very small percentage of its total T1 equivalents.

7. AT&T cannot use CLECs, however, to expand the number of buildings in which it bypasses the ILEC to any meaningful degree. Significantly, these CLECs do not offer access to most of the buildings where AT&T currently purchases four or more T1 equivalents from an ILEC. Thus, even within the subset of commercial buildings where AT&T purchases four or more T1 equivalents form the ILEC, AT&T could not replace the vast majority of those special access services with special access services purchased from CLECs.

8. Moreover, even where AT&T has a contractual arrangement with a CLEC, AT&T often cannot use that CLEC to provide access services. First, many CLECs have overstated the extent to which they have buildings "on-net." As noted above, AT&T has contractual arrangements with many of the major CLECs for the right to purchase special access services to any buildings in which they have facilities. In AT&T's

[1] My data are current as of March 2002.

experience, many of these CLECs initially represented that they had a certain number of buildings "on-net," but when AT&T seeks to roll service to their network, AT&T finds that the CLECs actually rely on the *ILEC's* special access services to reach the building. In other words, although CLECs frequently state that they have an impressive number of buildings "on-net," in AT&T's experience that often means that the CLEC is providing only some portion of the service over its own facilities (*i.e.*, that CLEC has deployed a fiber ring).

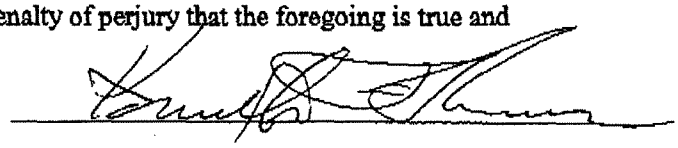
9. Second, most of the major CLECs that provide alternative access have gone bankrupt. Of the buildings available to AT&T that are served by CLECs other than AT&T, more than half of them are served by companies that have filed for bankruptcy. The widespread bankruptcies of these companies have made their access services largely unavailable to AT&T, because AT&T cannot assume that a bankrupt supplier will remain in business and continue to provide uninterrupted service.

10. Equally important, AT&T's potential customers are increasingly insisting that AT&T not rely on bankrupt (or potentially bankrupt) CLECs for any part of its service. Indeed, this has become increasingly true since the recent bankruptcy of WorldCom.

11. Third, capacity on CLEC networks also can be expensive, because CLECs typically provide only a modest discount off of the price umbrella of the Bells' special access services. Even worse, use of a CLEC's network often requires physically interconnecting with CLECs' facilities, which often poses costly logistical and other practical problems that do not exist with the ILECs, because of the ILECs' large integrated networks.

12. The hard reality is that AT&T and other IXCs remain critically dependent upon the ILECs for last mile access and this situation cannot be expected to change anytime soon. AT&T today purchases special access to approximately 186,000 buildings nationwide, but AT&T currently has even a theoretical facilities-based alternative in only a small fraction of those buildings. And as explained above, even that is overstated, since many of these buildings or (portions of these buildings) are off limits to AT&T because of bankruptcies, fiber to the floor arrangements, and the like. As a result, in the vast majority of cases, AT&T has no choice but to purchase special access services from the incumbent.

I, Kenneth Thomas, declare under penalty of perjury that the foregoing is true and correct.



Kenneth Thomas

Executed on October 15, 2002.